

**Before the  
Federal Communications Commission  
Washington, D.C. 20554**

In the Matter of

Rules and Policies to Promote New Entry	)	
And Ownership Diversity in the	)	MB Docket No. 17-289
Broadcasting Services	)	
	)	
To The Commission	)	

**COMMENTS OF THE FEDERAL COMMUNICATIONS COMMISSION'S  
ADVISORY COMMITTEE ON DIVERSITY AND DIGITAL EMPOWERMENT**

**A PROPOSAL FOR AN INCUBATOR PROGRAM**

April 1, 2018

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## Introduction and Executive Summary

The Advisory Committee on Diversity and Digital Empowerment (the “Committee”) respectfully submits these Comments in response to the Notice of Proposed Rulemaking in *2014 Quadrennial Regulatory Review – Review of the Commission’s Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, Notice of Proposed Rulemaking, 32 FCC Rcd 9857-64 (2017) (“*Incubator NPRM*”). These Comments were approved unanimously at the Committee’s March 27, 2018 regularly scheduled meeting.<sup>1</sup> A panel of the Third Circuit of the U.S. Court of Appeals has directed the Commission to “file a report on or before August 6, 2018 regarding the status of the incubator program.”<sup>2</sup>

In September 2017, the Commission tentatively agreed to adopt an incubator program that:

would provide an ownership rule waiver or similar benefits to a company that establishes a program to help facilitate station ownership for a certain class of prospective or existing station owners. For example, in exchange for a defined benefit, such as waiver of a broadcast ownership rule, an established company could assist a new owner by providing management or technical assistance, loan guarantees, direct financial assistance through loans or equity investments, training, or business planning assistance.<sup>3</sup>

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<sup>1</sup> Consequently, the Committee respectfully requests leave for consideration of these Comments out of time. *See* Order, MB Docket 17-289, DA 18-192 (MB, February 27, 2018).

These Comments represent the individual views of the Committee members and are not intended to represent the views of the organizations to which the Committee members belong, nor to represent the views of the Federal Communications Commission. All of the Committee members are volunteers, and none received compensation for his or her roles in developing, preparing, reviewing or approving these Comments.

<sup>2</sup> *Prometheus Radio Project v. FCC*, Nos. 17-1107 and 18-1092 *et al.*, Order (3d Cir., released February 7, 2018) (“*Prometheus IV Scheduling Order*”).

<sup>3</sup> *Incubator NPRM*, 32 FCC Rcd at 9859 ¶127. The incubator program contemplated herein is premised upon tax deferrals or tax credits for the incubating entities, rather than on waivers of a multiple ownership rule. *See* §§III-VII *infra*.

In these Comments, the Committee demonstrates how a broadcast incubator program could eliminate some of the common market entry barriers to women and minority ownership by providing increased opportunities for access to capital, while providing a pathway for entrepreneurs to avoid the effects of consolidation. Adoption of this incubator proposal would incentivize companies to provide entrepreneurs with opportunities to access capital, obtain assistance with engineering and technical issues, and leverage their wealth of experience through mentorship, thus enabling experienced managers to make the transition into ownership. The concept we flesh out in these Comments would not be difficult or resource-intensive to implement, and it would lend itself to monitoring and to evaluation via classical cost-benefit analysis.

The incubator concept originated in 1990 with a proposal by the National Association of Black Owned Broadcasters (“NABOB”) to the Minority Ownership Task Force, a federal advisory committee chartered by FCC Chairman Alfred Sikes. In 1992, the Commission asked for comment on the incubator concept in an NPRM.<sup>4</sup> It has since been considered in seven dockets. Much of the 28-year history is given in the *Incubator NPRM*, 32 FCC Rcd at 9857-9861 ¶¶122-130.<sup>5</sup>

We began by establishing these goals:

- *First*, to create a pathway for entrepreneurs with management experience, including minority and women entrepreneurs and especially those who have overcome

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<sup>4</sup> *Revision of Radio Rules and Policies*, Memorandum Opinion and Order and Further Notice of Proposed Rulemaking, 7 FCC Rcd 6387, 6391, 6391-92 ¶¶22, 24-25 (1992).

<sup>5</sup> For a complete history of the incubator concept, see MMTTC Comments, 2014 Quadrennial Review, MB Docket 14-50 (April 17, 2017) at 2 n. 2.

disadvantages, to acquire broadcast ownership experience and ultimately become owners;

- *Second*, to create a sufficient incentive for industry leaders to create incubators, allowing these industry leaders to grow their businesses while sharing, with others, opportunities these leaders enjoyed earlier in their careers.
- *Third*, to avoid creating ownership consolidation and, instead, bring about de-consolidation and deliver new voices to the airwaves; and
- *Fourth*, to design a program that would operate with the highest integrity, with minimal potential for abuse, and lend itself to monitoring and classical cost-benefit analysis.

The need to incubate new voices is especially urgent now in light of profound changes in market demographics since 1996 Telecommunications Act, which marked the last occasion when Congress calibrated the broadcast ownership rules.<sup>6</sup> Demographic changes since the 1990's underscore the need to provide more broadcast outlets for new voices, and especially for voices speaking in a variety of languages. In particular, between the 1990 Census and the 2016 Census estimates – just over a generation – our population has grown 30% (from 248.7M to 323.1M); the number of ethnic minorities including Hispanics of any race has grown 80% (from 49.0M to 88.4M), and the number of primary speakers of languages other than English has grown 109% (from 31.8% to 64.7%).<sup>7</sup> Few issues of communications policy are more urgent than the need to incubate a new generation of diverse broadcast owners to serve our much larger and more diverse population.

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<sup>6</sup> Telecommunications Act of 1996, §202.

<sup>7</sup> See pp. 57-58 *infra*.

To meet this need, the program would deliver value in three ways:

*First*, it would provide a mechanism by which the public can receive new voices;

*Second*, it would provide a pathway to enable those who have struggled to overcome disadvantages to enter the broadcasting industry; and

*Third*, it would provide industry leaders with a way to grow their businesses while sharing, with others, opportunities the industry leaders enjoyed earlier in their careers.

These attributes are important to the Commission because they speak to the interests of three of the agency's key stakeholders: the general public for whose benefit the Commission regulates in the public interest;<sup>8</sup> individuals who have struggled to overcome barriers to entry;<sup>9</sup> and enlightened leaders in the industry who seek to grow their businesses while promoting diversity.<sup>10</sup>

The *Incubator NPRM* contains, and we will undertake to answer, 57 questions regarding:

eligibility criteria for the incubated entity; appropriate incubating activities; benefits to the incubating entity; how such a program would be reviewed, monitored, and enforced; and the attendant costs and benefits.<sup>11</sup>

The Committee recommends that three types of race- and gender-neutral eligible entities could become participants in a program based on either of two incubation paradigms. The three types of eligible entities for incubation would be:

- Individuals who have overcome significant disadvantages (the “Overcoming Disadvantages Preference” or “ODP”, a concept recommended to the Commission in 2010 by the Advisory Committee on Diversity for Communications in the Digital

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<sup>8</sup> See 47 U.S.C. §151.

<sup>9</sup> See 47 U.S.C. §257.

<sup>10</sup> Cf. 47 U.S.C. §§309(j)(3)(B), 309(j)(4)(C), and 309(j)(4)(D).

<sup>11</sup> *Incubator NPRM*, 32 FCC Rcd at 9861 ¶130.

Age,<sup>12</sup> further fleshed out below,<sup>13</sup> in order to respond to the Commission’s questions);

- Mission-Based Entities, such as Historically Black Colleges and Universities (“HBCUs”); and
- Native American Nations recognized by treaties.

The Committee recommends that two types of incubation paradigms could be used. The two incubation paradigms are:

- A Joint Venture between an incubating company and an incubated company, under which they would jointly own and operate a full-service radio or TV station for a period to be determined by the Commission (the “Incubation Period”).<sup>14</sup> The incubated company could be new to broadcasting, or it could be an established broadcaster seeking to grow in size or make the leap from radio to television. The incubated company would exercise control while its principals are being trained by the incubating company for long-term ownership. Most of the financing would be provided by the incubating company, while some of the financing (most likely via a line of credit) would be contributed by the incubated company. At the conclusion of the Incubation Period, the incubated company would exercise a “call” option to acquire full equity ownership of the station. Upon the closing of that transaction, if Congress passes authorizing legislation, the incubating company would receive a Tax Certificate entitling it to deferral of capital gains taxes upon reinvestment in comparable property.<sup>15</sup>
- A Major Institutional Gift of a station to a Mission-Based Entity or a Native American Nation. Upon the making of such a gift, the incubating company would be eligible for a tax deduction or, even better, if Congress so authorizes, a tax credit in an amount equal to the appraised fair market value of the donated station.<sup>16</sup>

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<sup>12</sup> See n. 30 *infra*.

<sup>13</sup> See pp. 13-26 *infra*.

<sup>14</sup> See n. 70 *infra*.

<sup>15</sup> See ns. 74-75 *infra*. We recognize that establishing a new tax policy similar in some respects to the former Tax Certificate Policy is beyond the power of the Commission. The Commission’s demonstration to the Congress of the beneficial role of such a Policy in an Incubator Program is essential. The FAC hopes these Comments can assist the Commission in these efforts.

<sup>16</sup> See n. 83 *infra*.

The incentives to incubating companies would be grounded in tax policy – a sound choice in light of the FCC’s long and highly successful history operating the Tax Certificate Policy from 1978 to 1995, during which time the Policy quintupled minority broadcast ownership.<sup>17</sup> We have concluded that an incubator program that draws from the best elements of this predecessor tax program has an excellent chance of success, both in impact and in ease of execution.

Further, we believe that our incubator proposal offers the best opportunity in years for Congress to authorize a program that would have an impact comparable to the original Tax Certificate Policy. Under our model, only incubators would trigger tax relief to the seller or donor. Thus, when analyzed from the point of view of national tax policy, our model would be scored by the CBO as modest in size and narrowly focused. For every qualifying transaction, the taxpayers would be underwriting something of great value to all Americans.

The Joint Venture paradigm automatically discourages shams and frauds because both parties to the Joint Venture have funds at risk. Further protection from fraud is provided by strict requirements that Joint Sales Agreements (“JSAs”) and Shared Services Agreements (“SSAs”) be employed only for the first year of operation – *i.e.*, for startup training and only upon proof of need - to be removed promptly so that the incubated company can achieve full-service operations and, eventually, be in a position to incubate other entities. The Major Institutional Gifts paradigm has virtually no potential for fraud because the IRS’ asset appraisal requirements are so strict that abuse is nearly impossible.

The Committee implores the Commission not to create an incubator program simply for the sake of having such a program, or to “balance” changes in the structural regulations. Since

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<sup>17</sup> See ns. 74-75 *infra*.

we are concerned about the impact that consolidation can have on diversity, we are pleased that this proposal would promote new entry, thereby resulting in de-consolidation. We want companies to take advantage of it in most radio and television markets so that the program is impactful and genuinely transformative.

Administration of the selection of eligible entities, and of the operation of the incubation program itself, would not be burdensome for the participants or the Commission's staff. Evaluation and compliance assessment would follow the precepts of cost-benefit analysis and allow for public participation.

Thus, we commend this proposed incubator program to the Commission as a reasonable method of advancing diversity and inclusion in the nation's most important and influential industries. It is worthy of being attempted. We believe it would serve the public interest and could make a profound difference in the lives of broadcasters, entrepreneurs, and consumers of all backgrounds.

### **I. Earlier Objections to the Incubator Concept**

In the *2014 Quadrennial Review Report and Order*,<sup>18</sup> and subsequently,<sup>19</sup> a majority of the Commission denied a proposal by the Diversity and Competition Supporters ("DCS")<sup>20</sup> to

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<sup>18</sup> *2014 Quadrennial Regulatory Review, Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996 et al.*, Report and Order, 29 FCC Rcd 4371, 4514-16 (2014) ("*2014 Quad Review*"), *affirmed in part and reversed in part on other grounds, Prometheus Radio Project v. FCC*, 824 F.3d 33 (3d Cir. 2016) ("*Prometheus III*").

<sup>19</sup> *2014 Quadrennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996 et al.*, Second Report and Order, 31 FCC Rcd 9864, 10002 ¶321 (2016) ("*Second Report and Order*").

<sup>20</sup> The Diversity and Competition Supporters ("DCS") is a coalition of 30 national organizations that seek FCC initiatives favorable to equal opportunity for all Americans to participate as owners and managers in the electronic media.

provide waivers of the local radio ownership rule to broadcasters that finance or incubate an SDB or other “valid eligible entity.” DCS had proposed that an entity that engages in one or more of eight “qualifying incubating activities” be eligible for a waiver of the local radio ownership cap “by one station per incubating activity.”<sup>21</sup>

Objectors to DCS’ proposals suggested that the proposal might permit and encourage increased consolidation, resulting in a net decrease in minority and female ownership. When it rejected the incubator proposal in 2014, the Commission asserted that the “local radio rules have been carefully calibrated to protect competition and new entry. By allowing broadcasters to exceed these caps, DCS’s proposal could result in more local radio consolidation than is presently permitted under our rules.”<sup>22</sup>

The Commission further asserted that “it is unclear based on the record in this proceeding what kind of entities should be eligible to benefit from incubation,”<sup>23</sup> and the Commission expressed concern that the use of an SDB definition for eligible entities might not pass constitutional muster.<sup>24</sup>

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<sup>21</sup> DCS’ proposal was somewhat different from the one presented herein. In particular, DCS originally proposed that a broad menu of undertakings, such as training and financing, could be used as the basis for incubation, with ownership being just one of the options. The Committee is proposing, instead, that two options be available, both of them premised on ownership: (1) a Joint Venture between an incubating company and an incubated company, that leads to full ownership; and (2) a major gift to a mission-based institution such as an HBCU or to a Native American Nation recognized by a treaty. *See* §III *infra*.

<sup>22</sup> *2014 Quad Review*, 29 FCC Rcd at 4515 ¶313.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

Finally, the Commission expressed doubt that it would have the capacity to “monitor adequately the activities that would qualify an entity for an incubation waiver” such as financing and LMAs.<sup>25</sup>

## **II. Entities Eligible for Participation**

We are confident that the Commission, particularly working through its expert Office of Communications Business Opportunities (“OCBO”), possesses the expertise, the resources, and the ability, both on the macro- and micro-levels, to determine which classes of entities, and which individual entities, will be eligible to participate in an incubator program. The Committee considered six potential definitions for eligible entities, and determined that three of these six potential definitions have promise as means of promoting diversity of viewpoints and information.<sup>26</sup> The three potential definitions that have promise are the ODP, Mission-Based Institutions, and Native American Nations, all discussed below. These three definitions of eligible entities appear constitutionally permissible, easy to administer, not susceptible to abuse, and not so dilute that minorities and women would barely be included. We reject the proposed

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<sup>25</sup> *Id.* at 4515 ¶314.

<sup>26</sup> “Viewpoint diversity” refers to the availability of media content reflecting a variety of perspectives. The Supreme Court has held that “it has long been a basic tenet of national communications policy that the widest possible dissemination of information from diverse and antagonistic sources is essential to the welfare of the public.” *Turner Broadcasting System, Inc. v. FCC*, 512 U.S. 622, 663-64 (1994). A closely related concept, “information diversity,” favors the broad availability of information irrespective of its perspective or viewpoint. This interest is generally fostered by such content-neutral methods as the FCC’s structural ownership rules, which are designed so that they do not violate the First Amendment. *See FCC v. National Citizens Committee for Broadcasting*, 436 U.S. 775, 780 (1978). “Racial diversity,” developed in the courts largely through education law, is premised on the concept that exposure to a community of racially diverse individuals can enhance a student’s educational experience. *See Grutter v. Bollinger*, 539 U.S. 306, 337 (2003) (“*Grutter*”). Broadcast jurisprudence also includes the concept of racial diversity. *See Metro Broadcasting, Inc. v. FCC*, 497 U.S. 547 (1990) (applying intermediate scrutiny; the standard that would be applied after *Adarand Constructors, Inc. v. Peña*, 515 U.S. 200 (1995) is strict scrutiny). *See also* discussion of viewpoint, information, and racial diversity in n. 51 *infra*.

definitions based on new entrants,<sup>27</sup> revenue-based eligible entities,<sup>28</sup> and (until *Adarand* studies are performed) socially and economically disadvantaged businesses (“SDBs”).<sup>29</sup>

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<sup>27</sup> As the *Incubator NPRM* notes, the NAB had suggested that “the Commission create a standard similar to the new entrant bidding credit eligibility definition applicable in the broadcast auction context.” See *Incubator NPRM*, 32 FCC Rcd at 9861 ¶131, citing the NAB Petition for Reconsideration, MB Docket 14-50 (December 1, 2016) at 25. Under the broadcast auction rules, an auction participant is eligible for bidding credits if it has attributable interests in few or no other “media of mass communication.” 47 C.F.R. §73.5007(a); see also *id.* at §73.5008(b) (defining media of mass communication as “a daily newspaper; a cable television system; or a license or construction permit for a television broadcast station, an AM or FM broadcast station, or a direct broadcast satellite transponder”). A 35% bidding credit is awarded to a qualifying new entrant who has no attributable interest in any other media of mass communication, while a 25% bidding credit is awarded to a qualifying new entrant who holds an attributable interest in no more than three mass media facilities. *Id.* at §73.5007(a). Under the broadcast auction rules, a “new entrant” can be an incumbent broadcaster in other broadcast markets; thus, a “new entrant” seldom would be a newcomer to broadcast ownership. Consequently, virtually every broadcaster, except the handful of companies already operating in a community, would be eligible as “new entrants” if the broadcast auction rules were used as a model.

It appears that this “new entrants” definition could easily be exploited to benefit individuals who had the foresight to select wealthy parents or spouses. Such a practice was rampant in the era of comparative broadcast hearings, where it was used as a mechanism to defeat modest efforts to advance minority ownership. The FCC became obligated to consider minority ownership as a factor in comparative hearings in 1973. See *TV-9, Inc. v. FCC*, 495 F.2d 929 (D.C. Cir. 1973), *cert. denied*, 418 U.S. 986 (1974), *successfully applied in, e.g., Waters Broadcasting Corp.*, 91 FCC2d 1260, 1265 (1982), *aff’d sub nom. West Michigan Broadcasting Co. v. FCC*, 735 F.2d 601 (1984), *cert. denied*, 470 U.S. 1027 (1984) (African American woman entrepreneur awarded construction permit for new FM station in nearly all-White community based in part on her superior knowledge of the community relative to local competing applicant.) There followed much push-back and gamesmanship at the expense of minority new entrants. The use of spousal and parent-child relationships to game the system and defeat minority new entrants abounded during the last ten years of the comparative hearing era of broadcast licensing.

The Committee had the opportunity to review the results of 20 broadcast auctions held between 1999 and 2015. The underlying information on the race, ethnic origin and gender of participants in these auctions were collected from publicly available data in response to FCC Form 175, which is required to be filed as an indication of interest to participate in broadcast auctions. Expressions of whether an applicant is a “women-owned business” or a “minority-owned business” are voluntary; interested bidders are not required to so self-identify. Additionally, applicants do not provide the race, ethnicity, and gender of their constituent owners. Accordingly, there could be additional auction applicants with minority or woman ownership or control that are not reflected in these data. (In our experience, relatively few minority- or women-owned businesses pass up an opportunity to so self-identify.) There were 2,534 applicants in these auctions, of which 1,681 were found to be qualified. Of the qualified

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applicants, 1,457 (57.5%) were new entrants. Qualified minority-owned new entrants (12.4%) were slightly more prevalent than qualified minority-owned applicants who were not new entrants (8.7%); and qualified women-owned new entrants (10.8%) were slightly more prevalent than qualified women-owned bidders who were not new entrants (7.9%). Chi-square analyses comparing the numbers of minority, and women, new entrants to minority, and women total applicants respectively, revealed differences that were statistically significant for minorities vis-à-vis new entrants, and for women vis-à-vis new entrants.

Consequently, although the Committee does not recommend that the Commission use this “new entrant” definition due to the difficulty in preventing abuse, the Committee suggests that if other definitions fail, the Commission might revisit this definition to consider whether, for example, a “new entrant” definition that omits “legacy” applicants, such as the children or spouses of broadcasters, might have some utility.

<sup>28</sup> An eligible entity under this definition is any commercial or non-commercial entity that qualifies as a small business consistent with Small Business Administration (“SBA”) revenue grouping according to industry. Additionally, the Commission requires a small business eligible entity to hold: (1) 30% or more of the stock/partnership shares and more than 50% voting power of the corporation or partnership that will hold the broadcast license; (2) 15% or more of the stock/partnership shares and more than 50% voting power of the corporation or partnership that will hold the broadcast license, providing that no other person or entity owns or controls more than 25% of the outstanding stock or partnership interest; or (3) more than 50% of the voting power of the corporation if the corporation that holds the licenses is a publicly traded corporation. *Second Report and Order*, 31 FCC Rcd at 9983-84 ¶286. This definition is controversial because nearly all broadcast stations are “small businesses” under the SBA’s definitions. According to the SBA, an entity can be classified as a small business if it has \$38.5 million or less in yearly receipts. Regarding radio stations, see U.S. Census Bureau, Table No. EC1251SSSZ4, *Information: Subject Series – Establishment and Firm Size: Receipts Size of Firms for the United States: 2012* (515112 Radio Stations; most recent data), available at [https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ECN\\_2012\\_US\\_51SSSZ4&prodType=table](https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ECN_2012_US_51SSSZ4&prodType=table) (last visited February 12, 2018). Regarding television stations, see U.S. Census Bureau, Table No. EC1251SSSZ4, *Information: Subject Series – Establishment and Firm Size: Receipts Size of Firms for the United States: 2012* (515120 Television Broadcasting; most recent data); available at [https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ECN\\_2012\\_US\\_51SSSZ4&prodType=table](https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ECN_2012_US_51SSSZ4&prodType=table) (last visited February 21, 2018).

Therefore, this “revenue-based eligible entities” definition has little or no value in advancing ownership diversity in the broadcast context. The Third Circuit of the U.S. Court of Appeals has pointed this out to the Commission repeatedly. In *Prometheus Radio Project v. FCC*, 373 F.3d 372, 428 n. 70 (3d Cir. 2004) (“*Prometheus I*”), the Court stated that it “anticipate[d] that by the next [2006] quadrennial review the Commission will have the benefit of a stable definition of SDBs, as well as several years of implementation experience, to help it reevaluate whether an SDB-based waiver will better promote the Commission’s diversity objectives” [compared to the revenue-based definition of eligible entities being used.]” Seven years later, the same panel rejected a revenue-based test and “re-emphasize[d] that the actions required on remand should

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be completed within the course of the Commission’s 2010 Quadrennial Review of its media ownership rules.” *Prometheus Radio Project v. FCC*, 652 F.3d 431, 472 (3d Cir. 2011) (“*Prometheus II*”). In *Prometheus Radio Project v. FCC*, 824 F.3d 33, 48-50 (3d Cir. 2016) (“*Prometheus III*”), the Court found that the Commission, for the third time, had improperly adopted a revenue-based test.

<sup>29</sup> As the *Incubator NPRM* notes, “the SDB standard is based on the definition employed by the SBA. Pursuant to the SBA’s program, persons of certain racial or ethnic backgrounds are presumed to be disadvantaged; all other individuals may qualify for the program if they can show by a preponderance of the evidence that they are disadvantaged. *Incubator NPRM*, 32 FCC Rcd at 9861 ¶131 and n. 386 (citing 13 C.F.R. §§124.103(b)-(c), 124.104(a)) and noting that “[t]o qualify for this program, a small business must be at least 51 percent owned and controlled by a socially and economically disadvantaged individual or individuals.” *See id.* at §124.105.

An SDB is defined as a company that is least 51 percent unconditionally owned by one or more socially and economically disadvantaged individuals. 13 C.F.R. §124.1002(b)(2). A disadvantaged individual is a person whose net worth is below \$750,000. 13 C.F.R. §124.1002(c).

The Committee believes that the Commission has not yet satisfied the constitutional requirement that before considering a potentially race-conscious program, it must first exhaust essentially all race-neutral remedies. *See Second Report and Order*, 31 FCC Rcd at 9987-88, 9999-10000 ¶¶297, 315-16 (determining that the evidence in the record was not sufficient to satisfy the constitutional standards to adopt the SDB standard or any other race- or gender-conscious measures). In particular, the Commission has failed to consider, implement, and evaluate a host of race-neutral proposals by civil rights organizations. To its credit, in 2017 the agency began to wade through a long backlog of these proposals. One of the many race-neutral proposals before the Commission that would have the effect of facilitating minority ownership is the incubator initiative contemplated in the *Incubator NPRM*.

Further, the Commission must conduct research (“*Adarand* studies,” named after *Adarand v. Peña*, 515 U.S. 200 (1995)) on racial disparities, to determine the extent to which they persist as a result of current discrimination or the present effects of past discrimination. The Commission conducted five such studies in 2000. *See*, among others, Ivy Planning Group, “Whose Spectrum Is It Anyway? Historical Study of Market Entry Barriers, Discrimination and Changes in Broadcast and Wireless Licensing – 1950 to Present” (FCC, December 12, 2000). It is long overdue for the Commission to undertake them again. Once these studies are completed, we believe an SDB paradigm could most likely be crafted to pass constitutional muster. In addition to their usefulness in crafting remedies, *Adarand* studies can facilitate time-series reviews of whether FCC policies are eliminating current discrimination and the present effects of past discrimination. Therefore, the Commission should perform *Adarand* studies not only because they are necessary to a determination of how to frame narrowly tailored race-conscious initiatives such as those grounded in SDB metrics, but because this research is vital to compliance with the congressional declaration, contained in the first sentence of the Communications Act, that the FCC was created *inter alia*, “to make available, so far as possible, to all the people of the United States, without discrimination *on the basis of race, color, religion, national origin, or sex*, a rapid, efficient, Nation-wide, and world-wide wire and radio

**Definition 1: Overcoming Disadvantages Preference.** ODP was first proposed in 2010 by the Commission’s Advisory Committee on Diversity for Communications in the Digital Age. It was designed “for individuals who have faced substantial disadvantages and have overcome those disadvantages.”<sup>30</sup>

The ODP is a race- and gender-neutral preference focused solely on the experiences and efforts of an individual person. The ODP is based on the belief that awarding licenses to those who have demonstrated mettle by working to overcome disadvantages would advance the Commission’s goals of promoting competition and diversity in licensing. Rather than affording a preference for race or gender, or even to counterbalance the effects of discrimination on the basis of race or gender, the ODP would afford a preference to those who strived, through superior individual efforts, to attempt to overcome major impediments to success. Race or gender would not create a presumption of disadvantage; and experiencing disadvantage, standing alone, would not trigger a benefit. Rather it is the individual’s *efforts* to overcome the disadvantage – a factor twice removed from race or gender – that would give rise to the preference.

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communication service[.]” 47 U.S.C. §151 (with italicized language added in the Telecommunications Act of 1996).

<sup>30</sup> See *Preference for Overcoming Disadvantage*, Recommendation of the Advisory Committee on Diversity for Communications in the Digital Age (October 14, 2010), available at <https://www.fcc.gov/DiversityFAC/101410/preference-101410.doc> (last visited February 11, 2018) (“2010 ODP Recommendation”), p. 1. The Committee extends its appreciation to retired Covington & Burling Managing Partner Jonathan Blake, who came up with the idea of the ODP as a method of solving the quandary of affirmative action by advancing racial and gender diversity, incentivizing excellence, and rewarding individual initiative all at the same time. We believe history will regard the ODP as one of the great ideas to promote civil rights. The Committee further extends its appreciation to Christopher Wright, a Partner at Harris, Wiltshire & Grannis and a former FCC General Counsel, who as *pro bono* counsel to MMTC reviewed this Section II of these draft Comments.

In Committee members' experience, the making of these individual efforts is one of the strongest predictors of business success in a complex field like broadcasting. The Commission will want to avoid the necessity of calling licenses back for re-issuance after they have been under-utilized or inefficiently deployed – a common and unfortunate recurring theme in FCC jurisprudence.<sup>31</sup> With their business and regulatory reputations on the line, investors in incubators will want to avoid having their incubators fail thereby causing distress at the FCC.

In 2014, the Commission rejected the ODP, expressing these concerns:<sup>32</sup>

Commenters generally did not suggest criteria, other than race and ethnic origin, that could be considered in an individualized, holistic evaluation system like that approved in *Grutter* [*Grutter v. Bollinger*, 539 U.S. 306 (2003)]. DCS recommended that the Commission replace its revenue-based eligible entity definition with an ODP standard as a race-neutral means of advancing ownership diversity. We note that it is not entirely clear whether the proposed ODP standard would be subject to heightened constitutional scrutiny. Moreover, we believe that we do not have a sufficient record at present on a number of issues that would need to be resolved prior to the implementation of an ODP standard. Among other issues, no commenter provided input on (1) what social or economic disadvantages should be cognizable under an ODP standard, (2) how the Commission could validate claims of eligibility for ODP status, (3) whether applicants should bear the burden of proving specifically that they would contribute to diversity as a result of having overcome certain disadvantages, (4) how the Commission could measure the overcoming of a disadvantage if an applicant is a widely held corporation rather than an entity with a single majority shareholder or a small number of control persons, and (5) how the Commission could evaluate the effectiveness of the use of an ODP standard. Even if we could develop an adequate record on these issues, we are concerned that the Commission may lack the resources to conduct such individualized reviews.

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<sup>31</sup> See, e.g., *Implementation of Section 309(j) of the Communications Act – Competitive Bidding*, Report and Order, 9 FCC Rcd 2348, 2382 ¶197 (1994) (warning auction bidders that the agency is “adopting penalties to be assessed in the event of default or disqualification. These penalties will provide strong incentives for potential bidders to make certain of their qualifications and financial capabilities before the auction so as to avoid delays in the deployment of new services to the public that would result from litigation, disqualification and re-auction.”)

<sup>32</sup> See *2014 Quadrennial Regulatory Review – Review of the Commission’s Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, Report and Order, 29 FCC Rcd 4371, 4506 ¶300 (2014). See also *Second Report and Order*, 31 FCC Rcd at 9987 ¶¶295-296 (to the same effect).

Moreover, the Commission would have to walk a very fine line in order to fully evaluate the potential diversity contributions of individual applicants without running afoul of First Amendment values. We are concerned that the type of individualized consideration that would be required under an ODP standard could prove to be administratively inefficient, unduly resource-intensive, and inconsistent with First Amendment values. We seek comment on these issues and our foregoing analysis regarding the feasibility of adopting an ODP standard [fns. omitted].

In the *Incubator NPRM*, the Commission asks the following questions (which we have reworded slightly to apply to the ODP):

*Are there any changes to the ODP proposal that would help address previous concerns expressed by the Commission? How does the ODP align with our goal to help facilitate ownership opportunities for entities that lack access to capital and operational experience and thereby promote competition and viewpoint diversity in local markets?*<sup>33</sup>

**Answer:** We respond to each of the concerns the Commission has expressed.

**1. Would the proposed ODP standard be subject to heightened constitutional scrutiny?** Strict scrutiny should not apply because the preference would be awarded in a race- and gender-neutral manner. It may be that members of minority groups and women will be more likely than others to obtain a preference, but that would only be because they tend to face more disadvantages.

In *Texas Department of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*,<sup>34</sup> the Supreme Court held that “[w]hen setting their larger goals, local housing authorities may choose to foster diversity and combat racial isolation with race-neutral tools, and mere awareness of race in attempting to solve the problems facing inner cities does not doom that endeavor at the outset.”<sup>35</sup> That reasoning is applicable to the ODP as well. As

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<sup>33</sup> See *Incubation NPRM*, 32 FCC Rcd at 9862 ¶132.

<sup>34</sup> 135 S. Ct. 2507 (2015).

<sup>35</sup> *Id.* at 2525.

noted above, it is possible that the ODP will result in increased participation in broadcasting by members of minority groups and women as well, but “mere awareness” of race and gender should not trigger strict scrutiny.

The ODP is an example of the sort of remedial measure expressly approved in *City of Richmond v. J.A. Croson Co.*,<sup>36</sup> where the plurality concluded that communities should seek “to eliminate racial disparities through race-neutral means.” Of course, eliminating racial disparities requires some awareness of race. Justice Scalia, concurring in *Croson*, hypothesized (and approved of) a preference that is similar in this respect to the ODP by stating that nothing prevents “a contracting preference to identified victims of discrimination” because “even though most of the beneficiaries might be black, neither the beneficiaries nor those disadvantaged by the preference would be identified on the basis of their race.”<sup>37</sup>

Similarly, in *Fisher v. University of Texas*,<sup>38</sup> the Court upheld the University’s express consideration of race in making admission decisions. More pertinent to the ODP program, the petitioner did not even challenge Texas’s decision to admit students graduating in the top ten percent of their high school classes - but rather argued that the race-neutral Top Ten Percent Plan approach should be expanded to increase minority enrollment.<sup>39</sup> The ODP would be even less race-conscious than the Top Ten Percent Plan.

Finally, for decades, critics of affirmative action plans have argued that poor White Appalachians are as deserving of preferences as many members of minority groups and that

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<sup>36</sup> 488 U.S. 469, 510 (1989) (plurality opinion) (“*Croson*”).

<sup>37</sup> *Id.* at 526-27. Actually, the ODP is one additional step removed from race-consciousness, since the ODP focuses on individuals’ efforts to overcome disadvantages.

<sup>38</sup> 136 S.Ct. 2198 (2016).

<sup>39</sup> *Id.* at 2213.

affluent members of minority groups are not deserving. The ODP is available to poor White Appalachians and to qualified applicants of any race.

**2. What social or economic disadvantages should be cognizable under an ODP standard?**

A comprehensive list of disadvantages would add certainty and should be included in the final rule, even though it would omit disadvantages not in the record. Especially when the program is in its early stage, applicants should be expected to consider only the list of disadvantages in the final rule, which could be a list such as that presented by the 2010 Advisory Committee.<sup>40</sup> The list should not be “fluid” because it would be unfair if an applicant is denied a preference because the disadvantage it overcame was not on the original list but

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<sup>40</sup> These were:

1. Physical disabilities or psychological disorders that rendered professional or business advancement substantially more difficult than for most individuals;
2. Physical or emotional trauma suffered in connection with military service;
3. Unequal access to institutions of higher education, including due to physical limitations, psychological disorders, substantial economic disadvantage, natural or human disaster, or as a result of discrimination;
4. Unequal access to credit, including due to physical limitations, psychological disorders, substantial economic disadvantage, natural or human disaster, or as a result of discrimination;
5. Treatment in hiring, promotions, and other aspects of professional advancement, pay and fringe benefits, and other terms and conditions of employment, or unequal treatment in other business opportunities;
6. Exclusion without cause from business or professional organizations or from social and professional associations with students or teachers;
7. Retaliatory or discriminatory behavior by an employer or an educational institution; or
8. Social patterns or pressures which have discouraged the individual from pursuing education or business opportunities or which have made pursuing such opportunities more difficult.

*See* 2010 ODP Recommendation, pp. 3-4.

appears on a subsequent list. If there is a time to consider amending the list, that time would be the occasion of a subsequent major rulemaking after the program has attained maturity.

We emphasize that success or failure in overcoming obstacles is not pertinent. What matters is effort; the steps the person took to persevere. For example, minorities, women, and the disabled have historically faced unequal treatment in hiring.<sup>41</sup> These groups have experienced exclusion, without cause, from business and professional organizations, thus hindering opportunities to learn from colleagues and network for new business.<sup>42</sup> When such individuals speak out against discrimination on the job or in the industry, they may be met with retaliatory behavior from an employer or the institution in question. Those who have faced

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<sup>41</sup> See A. Haveman & Lauren S. Beresford, *If You're So Smart, Why Aren't You the Boss? Explaining the Persistent Vertical Gender Gap in Management*, 639 ANNALS 114, 118 (2012) (discussing, *inter alia*, how in recent years, “trends for women’s educational attainment and representation in management diverged, as the percentage of female managers declined slightly, while the percentage of women earning business BAs and MBAs continued to rise”). Recent studies show how educational stratification, with fewer women in top-ranked MBA programs and more in lower-ranked programs, helps to maintain gender inequality in management. *Id.* In 2010, “[O]nly 31 percent of MBA students in the top U.S. business schools [were] female, compared with 45 percent across all MBA programs.” *Id.* Out of the top twenty U.S. business schools, female attendance has increased to 38.15% in 2018, indicating that educational stratification still exists as one of the first major hurdles that women face heading into the industry. See *Global MBA Ranking 2018*, FINANCIAL TIMES, available at <http://rankings.ft.com/businessschoolrankings/global-mba-ranking-2018> (last visited February 17, 2018). It will still take until 2085 at our current pace for U.S. women to reach parity with men in leadership roles, indicating that hiring women has almost leveled off in recent years. See Diana Mitsu Klos, *The Status of Women in the U.S. Media 2013*, WOMEN’S MEDIA CENTER 2013, available at [http://wmc.3cdn.net/51113ed5df3e0d0b79\\_zzzm6go0b.pdf](http://wmc.3cdn.net/51113ed5df3e0d0b79_zzzm6go0b.pdf) (last visited February 17, 2018).

<sup>42</sup> See Symposium, *Women and the “New” Corporate Governance: Pathways for Obtaining Positions of Corporate Leadership*, 65 MD. L. REV. 504, 524–29 (2017) (illustrating how gender plays a role by inhibiting mentor-mentee relationships and how women must take part in cross-gender mentoring relationships to find senior mentors). Over multiple studies on women of color, respondents identified the “lack of a mentor as the [number-one] barrier to advancement.” See Catalyst Inc., *Women of Color in Corporate Management: Three Years Later 13* (2002), available at [http://www.catalyst.org/system/files/women\\_of\\_color\\_in\\_corporate\\_management.pdf](http://www.catalyst.org/system/files/women_of_color_in_corporate_management.pdf) (last visited February 17, 2018).

discrimination, socioeconomic disadvantage, or have fought for our country and returned home after serving in the military, may have trouble accessing capital or credit necessary to start or maintain a business.<sup>43</sup> In these scenarios, unfair hiring and lack of access to capital could be considered the results of disadvantage.

To reduce arbitrariness, the Commission may also consider linking the degree to which the person's circumstances caused further socioeconomic disadvantage.<sup>44</sup> Socioeconomic-based assessments of disadvantage may be preferable to assessments of disadvantage that are not

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<sup>43</sup> The lack of access that minorities, especially African Americans and women, have to capital markets and credit is well documented. One national study including measurements of business lines of credit showed that male startup owners have lines of credit three times larger than those of females on average, and White owners have lines of credit nearly seven times larger than African Americans, three times that of Latinos, and more than twice that of Asian owners. See Loren Henderson, *Credit Where Credit is Due?: Race, Gender, and Discrimination in the Credit Scores of Business Startups*, 42 REV. BLACK POLITICAL ECON. 1 (2015) (illustrating that minorities “appear to suffer discrimination both at the point of determining credit score and at the point of lenders’ lending decisions”). Women have problems accessing credit despite 1970’s legislation like the Equal Credit Opportunity Act. See Alicia Robb, *The Role of Race, Gender, and Discrimination in Business Survival*, at 20 (2000) (unpublished Ph.D. dissertation, U.N.C.), ProQuest Dissertations Publishing, 9968662), available at <https://search.proquest.com/pqdtglobal/docview/304609325/89FF57A02CE24061PQ/1?accountid=14585> (last visited February 20, 2018) (finding that although the researchers did not find differences in demand for credit, the lending patterns of these small businesses indicate that women were supplied less credit from various credit sources); see e.g., Small Business Admin., Small Business Administration Goaling Report (2017), available at [https://www.fpds.gov/downloads/top\\_requests/FPDSNG\\_SB\\_Goaling\\_FY\\_2016.pdf](https://www.fpds.gov/downloads/top_requests/FPDSNG_SB_Goaling_FY_2016.pdf) (last visited February 17, 2018) (showing that women are disproportionately disadvantaged with respect to access to government contracts – nearly 22% of all small businesses in 2017 – but were awarded less than 5% of all federal contracting dollars).

<sup>44</sup> Linking socioeconomic disadvantage can help the Commission to create empirically detailed guidelines for the determination of a preference. This would advance an individualized, holistic view of *Grutter*, 539 U.S. at 337. See also EEOC Uniform Guidelines on Employee Selection Procedures, Sec. 13(A), available at <http://www.uniformguidelines.com/uniformguidelines.html#16> (last visited February 11, 2018)) (“Nothing in these guidelines is intended to preclude the use of lawful selection procedures which assist in remedying the effects of prior discriminatory practices, or the achievement of affirmative action objectives.”) The guidelines support the focus on socioeconomic disadvantage because remedying the effects of socioeconomic disadvantage influenced by individual disadvantages is the primary goal of these EEOC guidelines.

linked to an individual's circumstances so long as the assessments are narrow and serve the specific purpose of the Commission's action.<sup>45</sup>

When measuring the degree of success in overcoming a substantial disadvantage necessary to assess an applicant's eligibility for an ODP, the Commission should not institute a bright-line test defining the extent of disadvantage that has been overcome. Instead, the Commission could compare the net socioeconomic status of the applicant to the net socioeconomic status of other persons who have experienced a similar substantial disadvantage.

An example of this approach is found when comparing the success of college graduates from various socioeconomic backgrounds. A Gates Foundation study shows that the completion rate for part-time students who work is far lower than the rate for full-time students at community four-year institutions.<sup>46</sup> Full-time, non-working students graduate more often on

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<sup>45</sup> See Richard H. Fallon, *Affirmative Action Based on Economic Disadvantage*, 43 *UCLA L. REV.* 1913, 1950 (1996). Guidelines could be narrowly tailored to address Fallon's three main concerns: (i) the nature of the disadvantages that poverty creates and that affirmative action is intended to offset; (ii) the precise justification, if any, for viewing particular affirmative action preferences as appropriate remedies for poverty-based disadvantages; and (iii) the relationship between affirmative action preferences for the poor and the "merit" principles that normal schemes for distributing benefits and opportunities are usually thought to embody. *Id.* at 1950. See Richard D. Kahlenberg, *Achieving Better Diversity: Reforming Affirmative Action in Higher Education*, Century Found. 1 (December 3, 2015), available at <https://tcf.org/content/report/achieving-better-diversity/> (last visited February 20, 2018) (showing how the educational partnership between secondary and higher education gave such guidelines during a 2014 case study of ten states that may be transposed to encourage diversity and empower new talent in the media industry). They were: 1) creating new partnerships with disadvantaged schools to improve the pipeline of low-income and minority students, 2) giving more preference to low-income and working-class students, 3) providing aid, 4) dropping legacy preferences for children of alumni, 5) policies to admit students who graduate at the top of their classes, and 6) facilitated transfer from community college systems. These guidelines translate to practices of mentorship, noticing work ethic, providing aid, looking outside the old boys club, recognizing talent, and helping usher in those who show commitment. *Id.* at 19–20.

<sup>46</sup> See *With Their Whole Lives Ahead of Them*, Public Agenda, Bill and Melinda Gates Foundation at 5-8 (2009), available at <https://www.publicagenda.org/files/theirwholelivesaheadofthem.pdf> (last visited February 17, 2018); see also, e.g., Paul Fain, *Third Try Isn't the Charm*, *Inside Higher Ed*, (November 15,

time, and therefore earn more income on average. In addition, a Century Foundation Study found that 73% of all college admissions were dominated by the top socioeconomic status quartile.<sup>47</sup>

Examining these factors, an applicant could be found to have overcome a substantial disadvantage if she can show that when entering college her income or the income of her parents put her in the lowest quartile of socioeconomic status. Nevertheless, she graduated in four years, and earned income commensurate to those working in the first years after graduation who were members of the highest socioeconomic quartile. She could claim to have, through dint of effort,

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2013), available at <http://www.insidehighered.com/news/2013/11/15/students-are-unlikely-graduate-if-they-stop-out-more-once-study-finds#ixzz2ktGHdrGo> (last visited March 28, 2018) showcasing a 2013 study of a Texas university revealing that wage increases have a roughly 4% effect on the odds of dropping out and a 13% decrease in the odds of graduation).

<sup>47</sup> See Anthony P. Carnevale and Stephen J. Rose, *Socioeconomic Status, Race/Ethnicity, and Selective College Admissions*, in *America's Untapped Resource: Low-Income Students in Higher Education* 101–156, CENTURY FOUND. (2004) (“While those from families in the lowest SES quartile had a graduation rate of 55 percent, those from the highest SES quartile had a much higher rate, 73 percent. Virtually all of this 18 percentage point difference is determined by factors prior to enrolling in college – *i.e.*, SAT scores, high school grades, rigor of high school courses taken, etc.”) In 2008, low-income families had the highest high school dropout rate among persons 16–24 (11.6%), while high-income families were considerably lower (2.8%). See *Percentage of High School Dropouts Among Persons 16 Through 24 Years Old (Status Dropout Rate), by Income Level, and Percentage Distribution of Status Dropouts, by Labor Force Status and Educational Attainment: 1970 through 2007*, National Center for Education Statistics (2008), available at [http://nces.ed.gov/programs/digest/d08/tables/dt08\\_110.asp](http://nces.ed.gov/programs/digest/d08/tables/dt08_110.asp) (last visited February 20, 2018). The socioeconomic gap remains three times larger than the racial gap, and few low-income students reach selective universities. See Anthony P. Carnevale and Jeff Strohl, *Separate and Unequal: How Higher Education Reinforces the Intergenerational Reproduction of White Racial Privilege*, Georgetown University 12 (2013), available at <https://www.issuelab.org/resources/15589/15589.pdf?download=true> (last visited February 20, 2018) (showing that “high-income students are overrepresented by an astounding 45 percentage points, and low-income students are underrepresented by 20 percentage points”); Catharine Hill, *Improving Socioeconomic Diversity at Top Colleges and Universities*, Huffington Post (June 5, 2013), available at <https://www.huffingtonpost.com/catharine-hill/improving-socioeconomic-d b 3015590.html> (last visited February 20, 2018) (reporting that only 10% of students attending selective institutions come from the bottom 40% of income distribution in 2001, and little progress has been made since).

taken substantial steps to at least partly overcome a substantial disadvantage: an ideal candidate for the preference.<sup>48</sup>

**3. How could the Commission validate claims of eligibility for ODP status?** The “Open Government Awards” program, described at [www.opengovpartnership.org](http://www.opengovpartnership.org), may be used as a model by the FCC to validate claims of eligibility. In that program, candidates are required to explain, in 250 words or less, the program they developed to advance government transparency. They then have 450 words to describe the impact of their program, followed by 200 words to explain why it will be sustained. Then, in 150 words or less, candidates make their “pitch” for why they should receive an award. The applications for an ODP may allow for more explanation, but the Commission should limit the length of applications to make the program administrable.

For the ODP program, applicants should be required to concisely explain how they overcame or are in the process of overcoming a significant and cognizable disadvantage. Candidates should be directed to consider the list of disadvantages discussed in the 2010 ODP Recommendation, but should not necessarily limit themselves to those disadvantages.

Candidates should also be required to attach a resume and briefly document that they have overcome disadvantages to an extent that they can successfully run a broadcast business. In addition, applicants should indicate that they understand that they are bound by all rules and policies the Commission adopts, particularly those regarding real parties in interest, and maintenance of control of the enterprise.

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<sup>48</sup> This illustrates why Commission evaluation of ODP applicants for an incubator program would not be more difficult, or materially different in kind, than a university’s evaluations of otherwise minimally qualified applicants for undergraduate school, graduate school, or law school.

To select and credential the applicants, we propose that a committee of three Commission employees evaluate the applications. The employees could be drawn from the senior staff of OCBO, the agency's office with deep subject matter expertise. At the first stage of the selection process, we propose that a candidate's qualifications to control a license should count for 33% of the score given by the evaluators, with the caveat that an applicant found not to be qualified would not receive further consideration. The remaining 67% would be awarded based on the severity of the disadvantage the applicant overcame and the extent to which the applicant has succeeded despite the disadvantage. Of course, candidates who do not agree to be bound by the Commission's rules would immediately be disqualified.

There is necessarily some subjectivity concerning determinations of the severity of a disadvantage and a person's degree of success in overcoming it. However, making routine personnel decisions and selecting award winners also involve subjective decisions.

After the three evaluators give their scores, the applicants should be permitted to make oral presentations, of perhaps 30-60 minutes, to the committee. The committee could meet monthly. We suggest that the committee should choose the qualified applicants. The committee could approve all or none of the applicants.<sup>49</sup>

The committee could perform this task as applications for specific incubation projects are presented, or it could choose to grant an entity a general ODP certification, renewable every year, which would act as a "coin" to assist the entity to go into the marketplace and raise capital. Such credentialing would serve as an FCC validation that an eligible entity could bring to investors and lenders, thus enhancing its access to capital. An example of such a validation is the Section 8(a) certification afforded to eligible contractors by the Small Business

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<sup>49</sup> The incubation proposal presents no issues triggering *Ashbacker Radio Corp. v. FCC*, 326 U.S. 327 (1945).

Administration. The holder of such a certification can use it to demonstrate eligibility for certain federal contracts, thereby attracting investors and facilitating the growth and long-term stability of the business.<sup>50</sup>

**4. Would applicants bear the burden of proving specifically that they would contribute to diversity as a result of having overcome certain obstacles?** No. The best way for the Commission to promote diversity is to lift the barriers to broadcast ownership that are faced by disadvantaged persons. The Commission has always advanced diversity by developing policies that, *in the aggregate*, are likely to produce diverse outcomes – as opposed to compelling potential broadcasters to exhibit specific behaviors beyond the rule compliance expected of all broadcasters.<sup>51</sup>

**5. How can the Commission measure the overcoming of a disadvantage if an applicant is a widely held corporation rather than an entity with a single disadvantaged majority shareholder or a small number of control persons?** At least in the early stages of

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<sup>50</sup> U.S. Small Business Association, *Contracting: About the 8(a) Business Development Program*, available at <https://www.sba.gov/contracting/government-contracting-programs/8a-business-development-program/about-8a-business-development-program> (last visited February 20, 2018).

<sup>51</sup> The Commission advances diversity *in the aggregate* through its structural regulations, rather than insisting that each individual applicant or licensee make a predetermined contribution to the corpus of diversity available to consumers. *See, e.g., 2010 Quadrennial Regulatory Review – Review of the Commission’s Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, MB Docket No. 09-182, Notice of Proposed Rulemaking, 26 FCC Rcd 17489, 17495-96, ¶¶16-17 (2011) (stating that the Commission “has relied on its media ownership rules to ensure that diverse viewpoints and perspectives are available to the American people in the content they receive over the broadcast airwaves” and that the “media ownership limits are necessary to preserve and promote viewpoint diversity.” The Commission has further explained that it has “regulated media ownership as a means of enhancing viewpoint diversity on the premise that diffuse ownership among media outlets promotes the presentation of a larger number of viewpoints in broadcast content” than otherwise would be available. *See id.* at 17496 ¶16. In addition to viewpoint diversity, the Commission has considered the impact of its rules on program, outlet, source, and minority and female ownership diversity. *Id.*

the program, we recommend limiting applicants to a single disadvantaged shareholder or a small number of disadvantaged persons with control. Virtually every applicant under previous diversity programs, such as the 1978 Tax Certificate and Distress Sale Policies, had a single shareholder or small number of control persons; thus, the issue of widely-held corporate applicants seldom arose. Consequently, it is unlikely that this limitation on applicant structure would hobble the incubator program. Should this issue arise, the Commission may apply the SBA's well-established guidelines for small business ownership attribution.<sup>52</sup>

**6. How could the Commission evaluate the effectiveness of the use of an ODP standard?** Initially, the Commission should focus on whether the incubated stations succeeded in their mission of training qualified managers to become successful owner-operators. Did the managers transition into ownership? Did the incubated stations provide independent new and competitive voices to their markets?

Further, the Commission should consider the persons who were in the program because they demonstrated that they had struggled hard to overcome disadvantages. Did those persons have their specific disadvantages overcome by virtue of being a part of the incubator program? In this respect, if the disadvantages being overcome were race and gender discrimination, it would not be improper for the Commission to be aware of the race and gender of these individuals. If the program appears to have the capability of helping minorities and women overcome discrimination in broadcasting, that would be useful to know

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<sup>52</sup> See *Small Business Compliance Guide: Size and Affiliation*, U.S. Small Business Administration (March 2014), available at [https://www.sba.gov/sites/default/files/articles/affiliation\\_ver\\_03.pdf](https://www.sba.gov/sites/default/files/articles/affiliation_ver_03.pdf) (last visited March 10, 2018).

because race-neutral alternatives should be used before turning to other alternatives.<sup>53</sup> If the program turns out *not* to have the capability of helping minorities and women overcome discrimination in broadcasting, that would also be useful to know, because the Commission could refine the program or supplement it with other programs that might be more effective.

**7. Does the Commission possess sufficient resources to conduct individualized reviews?** The individualized reviews would be performed by OCBO staff who would review paper applications of modest length, and conduct 30-60 minute interviews with serious applicants.<sup>54</sup> Such reviews should not be resource-intensive or time-intensive.<sup>55</sup>

**8. How could the Commission fully evaluate the potential diversity contributions of individual applicants without running afoul of First Amendment values?** The selection committee would not consider the substantive messages likely to be found in the content that candidates propose to provide. Although it is likely that more diverse ownership, in the aggregate, will lead to more diverse programming, the Commission should not require individual applicants to show that they would provide different content or viewpoints than other broadcasters.<sup>56</sup> For that reason, the proposal presents no substantial First Amendment issues.

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<sup>53</sup> See *Parents Involved in Community Schools v. Seattle School Dist. No. 1*, 551 U.S. 701, 707 (2007) (Kennedy, J.) (holding that race-neutral means must be exhausted before state actors may consider race-conscious methods).

<sup>54</sup> See p. 21 *supra*.

<sup>55</sup> Nevertheless, if the Commission fears that it lacks the necessary resources, it could contract out the credentialing process to a professional firm that has performed this function for federal departments such as Defense, Commerce, Agriculture or Education, and perhaps allow the contractor to charge applicants a modest service fee.

<sup>56</sup> See n. 51 *supra*.

**Definition 2: Mission-Based Institutions.** Institutions such as Historically Black Colleges and Universities (“HBCUs”), Hispanic Serving Institutions (“HSIs”), Asian American Serving Institutions (“AASIs”), and Native American Serving Institutions (“NASIs”) are defined not by the race of many of their students, but by their missions of multicultural education.<sup>57</sup> As such, these institutions are regarded as race-neutral for equal protection purposes.<sup>58</sup> While not among the definitions expressly identified in the *Incubator NPRM*, the Committee considered this definition because, in many instances, mission-based institutions have played a major role in broadcast education and broadcast station ownership, doing so in the face of major disadvantages that sometimes persist to this day and might be partly curable by the donation of a broadcast facility.<sup>59</sup> Probably the first broadcast incubator was station WHUR-FM, a full power station

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<sup>57</sup> For example, an HBCU is “any historically black college or university that was established prior to 1964, whose principal mission was, and is, the education of black Americans, and [] is accredited by a nationally recognized accrediting agency or association determined by the Secretary [of Education] to be a reliable authority as to the quality of training offered or is, according to such an agency or association, making reasonable progress toward accreditation.” Title VI of the Civil Rights Act of 1964, codified at 20 U.S.C. §1061 (2). *See also* Higher Education Act of 1965, Title V, codified at 20 U.S.C. §1101. These institutions admit students of all races and, indeed, some of them have relatively modest minority enrollments; for example, West Virginia’s Bluefield State College, which still receives HBCU funding, was 82% White as of 2011. *See e.g.*, Sarah Butrymowicz, *Historically Black Colleges Are Becoming More White*, TIME (June 27, 2014), available at <http://time.com/2907332/historically-black-colleges-increasingly-serve-white-students/> (last visited February 20, 2018).

<sup>58</sup> *See U.S. v. Fordice*, 505 U.S. 717, 749 (1992) (Thomas, J., concurring) (averring that a State may “operate a diverse assortment of institutions— including historically black institutions— open to all on a race-neutral basis, but with established traditions and programs that might disproportionately appeal to one race or another”). We leave it to the Commission’s judgment whether other institutions whose missions include the training of diverse students or personnel in broadcasting, besides HBCUs, HSIs, AASI’s and NASIs, should be encompassed within the agency’s definition of a “Mission-Based Institution.”

<sup>59</sup> A 1995 comparison by MMTC of 28 HBCUs’ stations and those belonging to the 29 predominantly White state colleges in the same states found that the predominately White schools’ stations average sign-on year was 1970; the HBCUs’ average sign-on year was 1980. The predominately White schools’ stations mean power level was 40.57 kw, 20% more than the HBCUs’ stations’ mean power level of 33.8 kw. The predominately White schools’ mean

donated by The Washington Post Co. to Howard University in 1969 and used for several years primarily for student training. More recently, in 2013 American Spirit Media donated full power TV station WLOO-TV, Vicksburg (Jackson), MS to Tougaloo College, which uses it for student training and operates it with an SSA with Raycom Media's WLBT-TV in Jackson.

**Definition 3: Native American Nations.** It is well established that a self-governing Native American Nation, recognized by the federal government pursuant to a treaty, may be treated for Fourteenth Amendment equal protection purposes as an eligible entity without implicating the issue of race-neutrality. Nationhood, not race, defines the treaty relationship.<sup>60</sup> The FCC has a long history of encouraging the deployment of spectrum for the benefit of these Nations,<sup>61</sup> recognizing that their inhabitants often suffer from a lack of resources necessary for

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HAAT was 671.4 feet, almost 2 ½ times the HBCUs' stations' mean HAAT of 273 feet. Thus, the HBCUs were given a late start, after which they received second-class broadcast facilities. For the most part, they still broadcast on these second-class facilities.

<sup>60</sup> Native American nationhood was born originally out of the U.S. Constitution, and through subsequent congressional action and case law, sovereignty has gone on to include immunity from the Equal Protection Clause due to a Nation's political, not racial nature. U.S. CONST, art. I, §2, cl. 3 (stating that "Representatives and direct Taxes shall be apportioned among the several States [...] excluding Indians not taxed"); U.S. CONST, art. I, §8 (stating that "Congress shall have the power to regulate Commerce with foreign nations and among the several states, and with the Indian tribes"); U.S. CONST, amend. XIV, §2 (amending the apportionment of representatives in art. I, §2 above).

The famous Marshall Trilogy confirmed the legal and political standing of Indian Nations early on. See *Cherokee Nation v. Georgia*, 30 U.S. 1 (1831); *Johnson v. M'Intosh*, 21 U.S. (8 Wheat.) 543 (1823); and *Worcester v. Georgia*, 31 U.S. (6 Pet.) 515 (1832). Since these cases, the federal government has treated recognized Indian Nations as sovereign political entities over the status of racial groups within the United States. See David C. Williams, *The Borders of the Equal Protection Clause: Indians as Peoples*, 38 UCLA L. Rev. 759, 761 (1991). See, e.g., *Mudarri v. Washington*, 147 Wash. App. 590, 599–608 (2008) (dismissing plaintiff's claims that the State of Washington "allowing the Tribe to operate [casino] games, but not Mudarri, violates statutory and constitutional provisions" – namely, his equal protection rights – after the court's failure to join the defendant's tribe due to sovereign immunity).

<sup>61</sup> In 2010, the FCC established the Office of Native Affairs and Policy to "bring the benefits of a modern communications infrastructure to all Native communities by, among other things,

the basic attributes of “first world” citizenship.<sup>62</sup> Thus, a gift of a broadcast station to a Nation, if accompanied by the working capital, training, and institutional support necessary to support the operation of the gift, could constitute a viable incubator.

### III. Qualifying Incubation Activities

The *Incubator NPRM* asks for comment:

*on the activities that would qualify as incubation. Such activities would need to provide the incubated entity with support that it otherwise lacks and that is essential to its operation and ability to serve its community.”<sup>63</sup>*

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ensuring robust government-to-government consultations with Federally-recognized Tribal governments and other Native organizations, [...] and ensuring that Native concerns and voices are considered in all relevant Commission proceedings and initiatives.” *Establishment of the Office of Native Affairs and Policy in the Consumer and Governmental Affairs Bureau*, Order, 25 FCC Rcd 11104 (2010); *see also id.* at 11107 (Statement of Commissioner Michael J. Copps) (“now is the time to redeem promises to Native American communities” where “poverty endures, unemployment is at levels no society should tolerate, education languishes, and basic public safety falls far short of what people have a right to expect”).

<sup>62</sup> As adult citizens, American Indians and Alaska Natives fall far behind other Americans in such essential metrics as life expectancy, educational attainment, and income. *See* INDIAN HEALTH SERV., *Indian Health Disparities*, 1 (2017), available at [https://www.ihs.gov/newsroom/includes/themes/responsive2017/display\\_objects/documents/fact\\_sheets/Disparities.pdf](https://www.ihs.gov/newsroom/includes/themes/responsive2017/display_objects/documents/fact_sheets/Disparities.pdf) (last visited February 21, 2018), estimated to be 4.4 years less than the U.S. all races average – 73.7 to 78.1 years, respectively, circa 2017); U.S. Census Bureau, Table No. B15002C, *SEX BY EDUCATIONAL ATTAINMENT FOR THE POPULATION 25 YEARS AND OVER (AMERICAN INDIANS AND ALASKA NATIVES ALONE) Universe: American Indian and Alaska Native alone population 25 years and over, 2016 American Community Survey 1-Year Estimates: 2016*, available at [https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS\\_16\\_1YR\\_B15002C&prodType=table](https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_16_1YR_B15002C&prodType=table) (last visited February 21, 2018), (estimating that 20% did not graduate from a high school or earn an alternative credential in 2016); U.S. Census Bureau, Table No. B19301C, *PER CAPITA INCOME IN THE PAST 12 MONTHS (IN 2016 INFLATION-ADJUSTED DOLLARS) (AMERICAN INDIANS AND ALASKA NATIVES ALONE) Universe: People who are American Indian and Alaska Native alone, 2016 American Community Survey 1-Year Estimates: 2016*, available at [https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS\\_16\\_1YR\\_B19301C&prodType=table](https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_16_1YR_B19301C&prodType=table) (last visited February 21, 2018) (estimating average income per capita over 2016 at \$18,961).

<sup>63</sup> *Incubator NPRM*, 32 FCC Rcd at 9862 ¶133.

**Answer:** We commend two paradigms to the Commission as the ones it should select for its incubator program, at least initially: **Joint Ventures**, and **Major Institutional Gifts**. Other paradigms could be considered later upon evaluation of the success of the two initial paradigms.

**Paradigm 1: Joint Ventures.**<sup>64</sup>

**A. How a Joint Venture Would be Structured and Financed**

With respect to ownership structure and attribution, the Commission asks:

*Instead of a waiver to acquire a different station in the market (or a similarly sized market), should we allow the incubating entity to obtain an otherwise impermissible non-controlling, attributable interest in the incubated station? This would allow the incubating entity to obtain financial benefits that accrue from successful operation of the incubated station and would limit the impact on competition, both by ensuring that the incubated entity retains control of the station and by tying the ownership waiver to the period of time the incubated entity owns the station. Would such an approach dilute the contributions of the incubated station as an independent market participant?*<sup>65</sup>

**Answer:** A company qualifying as an eligible entity through the ODP that wishes to be incubated – the “incubated company” – would identify a station it cannot purchase because the incubated company lacks the requisite access to capital and/or management skill sets. To acquire access to capital and the skill sets, the incubated company would join forces with a well-established broadcaster in the market – the “incubating company” – in a Joint Venture. After the Incubation Period, the incubated company would buy out the incubating company’s interest in the Joint Venture, and the incubating company would be eligible to receive from the FCC, if Congress so authorizes, a Certificate entitling it to deferral of capital gains taxes on that transaction upon the incubating company’s reinvestment in comparable property.<sup>66</sup>

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<sup>64</sup> The Committee recognizes Broadcast Development Working Group member DuJuan McCoy, a television station owner, who conceived of this paradigm.

<sup>65</sup> *Incubation NPRM*, 32 FCC Rcd at 9863 ¶138.

<sup>66</sup> See ns. 74-75 *infra*.

Most likely the station chosen for incubation would be a full power television station or a major market FM station.<sup>67</sup> A high value property will be necessary for incubation if the incubating company is going to be able to enjoy a tax benefit at the end of its Incubation Period. Specifically, there will need to be sizeable capital gains to be deferred in order to motivate the incubating company to participate in the program.

The Joint Venture would own and operate the station for at least the length of the Incubation Period. During that time, the incubated company would have control,<sup>68</sup> consisting of ownership of a 51% or greater voting interest, as well as a 20% or greater equity interest in the Joint Venture; while the incubating company would hold no more than a 49% voting interest, and no more than an 80% equity interest, in the Joint Venture.<sup>69</sup>

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<sup>67</sup> On occasion, the incubation station could be an AM station. Some AM stations are rated #1 in their markets.

<sup>68</sup> A threshold question that often arises in connection with diversity programs is what constitutes “control” and how a passive investor can ensure that its less experienced partner will not make rookie errors that would jeopardize the economic success of the Joint Venture. Sometimes this question is answered by creating sham ownership structures and not telling the FCC or the public about it. See, e.g., *Edwin L. Edwards, Sr.*, 16 FCC Rcd 22236, 22247-50 ¶¶23-28 (2001) (“*Edwards*”). Another approach, which we recommend, is to create a category of voting but non-controlling stock, and then specify certain types of critical decisions to be made collaboratively by both parties – such as when certain very large expenditures can be made, when “key men” can be hired or fired, and when certain assets can be bought or sold. These decisions would require a supermajority of the board, and thus the votes of the incubating partner’s designees on the board. Such an approach, if not overly aggressive, can be a reasonable way for both parties to protect their interests while ensuring that the ownership structure is genuine.

<sup>69</sup> Thus the Joint Venture would not dilute the contributions of the incubated company as an independent market participant. The incubated company would maintain control and would be armed with an option to call the incubating company’s interest for no more than fair market value. The 20% equity standard for a policy to promote diversity is drawn from the recommendation of the Advisory Committee on Alternative Financing for Minority Opportunities in Telecommunications, which applied its recommendation to the 1978 Tax Certificate and Distress Sale policies. See *Commission Policy Regarding The Advancement of Minority Ownership in Broadcasting*, 92 FCC2d 849, 855 (1982) (adopting one of the recommendations of a federal advisory committee (the “Rivera Commission” after its Chair,

Although the incubating company would provide most of the Joint Venture's financing, the incubated company would provide some of the financing through, *e.g.*, a line of credit available by virtue of the incubated company's principals' broadcast experience. In this way, both companies would be financially at risk and motivated to ensure the venture's success.

The Commission should establish the Incubation Period of a sufficient length because the purpose of the program is to help companies that need assistance to overcome disadvantages and grow.<sup>70</sup> If a company has already overcome any disadvantages, or it never had any, it does not need incubation, and taxpayers (through the Tax Certificates to be issued to the incubating company) should not be paying for an opportunity these broadcasters no longer need. This program is specifically tailored for companies that have the entrepreneurial mettle, and potential for a high likelihood of success, if given the opportunity to run a quality station for the

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Commissioner Henry Rivera) to apply the minority ownership policies to companies for which voting control vested in minorities, if the minority principals possessed at least 20% of the shareholder equity). The 20% standard remains valid as a means of encouraging broad industry investments in ventures controlled by eligible entities while, at the same time, ensuring that these ventures would remain controlled by the eligible entity and not be sham operations.

<sup>70</sup> The Committee believes that three years is probably an appropriate Incubation Period, being approximately the time required for most energetic, motivated entrepreneurs, capable of running a business, to develop the on-the-job expertise to both operate and own a highly competitive broadcast business. However, this three-year estimate is not cast in stone. Another standard Incubation Period might work just as well. The Committee understands that inasmuch as an incubator program will depend upon the delivery of tax benefits, the Commission is going to have to work with Congress to establish the appropriate Incubation Period.

Incubation Period<sup>71</sup> under the tutelage of an experienced incubating company, but not the capital and skill sets, to succeed.<sup>72</sup>

During the Incubation Period, the incubating company – as the principal investor in the project – would provide the incubated company with the full range of engineering, technical, sales, management training, and mentoring the incubated company needs in order to grow the station competitively. These incubation benefits would flow naturally from the nature of a Joint Venture, in which both parties have economic “skin in the game.” Thus, the training and mentoring would not be “charity,” and a Joint Venture would require little FCC monitoring to ensure that some minimum floor of effort has been made. The beauty of the Joint Venture model is that the knowledge-transfer elements of incubation are hard-wired into the ownership structure’s DNA.

At the conclusion of the Incubation Period, the incubated company could exercise an option to call most, or all, of the incubating company’s interest. The option would be framed at the outset so that the incubated company reasonably could exercise the option at the end of the Incubation Period. Thus, the option price and terms would be commercially reasonable – fair market value or discounted.

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<sup>71</sup> There may be rare circumstances in which the incubated company finds itself ready to exercise 100% ownership and control prior to the expiration of the Incubation Period, and wants to call the incubating company’s stock at that time, thus “graduating early” out of incubation and into 100% ownership. In such an instance, the incubation program will have fulfilled its purpose, and the Commission could approve the early conclusion of the incubation relationship. This scenario should be regarded as exceptional, however.

<sup>72</sup> We anticipate that in the majority of instances, the incubated company would be a new entrant in the market. However, in some instances it would have already established a presence in the market, *e.g.*, as the owner of a weekly newspaper or a small AM station, and it will seek incubation in order to expand and diversify by acquiring an FM or television station. *See also* p. 50 *infra* regarding incubation of incumbent broadcasters.

Further, the incubating company would not hold a corresponding option that would permit the incubating company to call the incubated company's interest and thereby force the incubated company to yield up the station it had worked for years to acquire.<sup>73</sup>

Once the incubated company issues its "call" option, the parties would file a Form 316 application to assign the license from the Joint Venture to the incubated company.

Simultaneously, and assuming that Congress facilitates this element of the incubator program,<sup>74</sup>

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<sup>73</sup> The Commission has a long history of dealing with abusive options. In the past, a small company, often one finding itself on the wrong side of a long-term JSA or SSA, may discover that its option's price and terms were structured so that its option could never be successfully exercised. Whatever that is, it is not incubation. It is essential that the incubator program be designed to preclude this kind of exploitation.

When the Commission evaluates unilateral or bilateral option agreements, it should look for these elements:

- Coverage of voting and non-voting interests by the options
- Equivalence of each partner's puts and calls
- Time periods when options must be noticed and exercised
- Asset valuations – imputed in advance, made contemporaneously with exercise; who makes them, and how are they made
- Payments to be made in cash or with stock; penalties if not made.

See *Edwards*, 16 FCC Rcd at 22255 ¶38 for a discussion of lopsided options and financing.

<sup>74</sup> The program was adopted in *Statement of Policy on Minority Ownership of Broadcast Facilities*, 68 FCC2d 979, 983 (1978) ("1978 Minority Ownership Policy Statement") and repealed by Congress in 1995. Deduction for Health Insurance Costs of Self-Employment Individuals, Pub. L. No. 104-78, §2, 109 Stat. 93, 93-94 (1995).

It's important to remember that the Tax Certificate Policy adopted in 1978 to advance minority ownership, actually was an extension of an earlier policy, adopted in 1970, that was aimed at incentivizing *de-consolidation* by allowing those who voluntarily broke up local media combinations (*e.g.* cross-owned newspaper-broadcast combinations) to defer capital gains taxes on the transactions:

Under 26 U.S.C. §1071, the Commission can permit sellers of broadcast properties to defer capital gains taxation on a sale whenever it is deemed "necessary or appropriate to effectuate a change in a policy of, or the adoption of a new policy by, the Commission with respect to the ownership and control of radio broadcasting stations. . . ." Originally tax certification was used to remove the hardship of involuntary transfer as a result of divestiture imposed by the Commission's multiple ownership rules. Now, however, tax

the Commission would issue to the incubating company a Certificate entitling the incubating company to defer capital gains taxes on the sale of the incubating company's interest in the station upon reinvestment in comparable property.<sup>75</sup>

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certificates are routinely approved in voluntary sales as an incentive to licensees to divest themselves of communications properties grandfathered under the multiple ownership rules.

*1978 Minority Ownership Policy Statement*, 68 FCC2d at 984 n. 19 (quoting *Issuance of Tax Certificates*, 19 RR 2d 1831 (1970)).

Our proposed use of capital gains tax deferrals to reward incubation that brings new voices to a market is reminiscent of the voluntary de-consolidation spirit of the 1970 Policy, to which the 1978 Policy was appended.

The Commission has repeatedly encouraged Congress to restore a version of the 1978 Tax Certificate Policy. *See, e.g., Section 257 Triennial Report to Congress, Identifying and Eliminating, Market Entry Barriers, For Entrepreneurs and Other, Small Businesses*, 26 FCC Rcd 2909, 2965 ¶155 (2011).

The Government Accountability Office (“GAO”) has found the 1978 Tax Certificate Policy to have been one of the three primary factors driving minority ownership. *See* United States Government Accountability Office, Report to the Chairman, Subcommittee on Telecommunications and the Internet, Committee on Energy and Commerce, House of Representatives, *Media Ownership: Economic Factors Influence the Number of Media Outlets in Local Markets, While Ownership by Minorities and Women Appears Limited and Is Difficult to Assess* (March 2008) (“GAO Media Ownership Study”) at p. 5 (identifying these factors: “(1) the large scale of ownership in the media industry, (2) a lack of easy access to sufficient capital for financing the purchases of stations, and (3) the repeal of the tax certificate program—which allowed for the deferral of capital gains taxes on the sale of broadcast and other media outlets and, thereby, provided financial incentives for incumbents to sell stations to minorities.”)

The 1978 Tax Certificate Policy quintupled minority station ownership between 1978 and 1995. *See* Catherine J.K. Sandoval *et al.*, *Minority Commercial Radio Ownership in 2009: FCC Licensing and Consolidation Policies, Entry Windows, and the Nexus Between Ownership, Diversity and Service in the Public Interest* (2009) at p. 14, available at [www.mmtc.org](http://www.mmtc.org) (go to Sandoval MMTC 2009 final report) (last visited February 27, 2018).

<sup>75</sup> This procedure in all of its permutations, as practiced under the 1978 Tax Certificate Policy, is authoritatively described in Erwin Krasnow, William Kennard and Susan Temkin, *Maximizing the Benefits of Tax Certificates in Broadcast and Cable Ventures*, 3 HASTINGS COMM. & ENT. L.J. 753 (1990-1991).

## **B. Conclusion of Incubation**

At the end of the Incubation Period, one of two things would happen, each of which would serve the public interest:

- **Outcome A: Option Exercised; Tax Certificate Granted.** The incubated company exercises its option to acquire the incubating company's interest in the Joint Venture. The incubating company then receives a Tax Certificate. The public has enjoyed years of operation by a new voice in the market. Having graduated into long-term independent ownership, the incubated company is now in a position to grow its station, acquire additional stations and, perhaps, become an incubating company itself.
- **Outcome B: No Option Is Exercised.** The parties decide that they like the Joint Venture the way it is. The station simply continues to operate as a traditional new voice even though no further training of the original incubated company is necessary. The public benefits by having a new, financially secure independent voice in the market for the long term. The incubating company's option could be exercised later.<sup>76</sup>

## **C. Advantages of Joint Ventures as Incubating Facilities**

There are four distinct advantages of the Joint Venture approach:

*First*, because it is built around a specific station, there can be no disparity between the assets subject to a tax benefit and the assets subject to incubation.

*Second*, because both parties have resources at risk, the structure of the relationship will disincentivize gamesmanship. Further protection from fraud would be provided by strict requirements that JSAs and SSAs would be employed only in exceptional circumstances – for the first year of operation for startup training and only upon proof of need. That was the original purpose of these tools. They must be used only to assist in, and never to substitute for, incubation. See pp. 38-39 *infra*.

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<sup>76</sup> In such event, the deferral of capital gains taxes would cover only the tax years during which incubation occurred, unless the parties obtained leave from the Commission to continue to treat their relationship as an incubator. Since the Commission would approve the incubators, it would determine when they commence and conclude for regulatory and tax purposes.

*Third*, the Joint Venture approach is not premised on waivers. Thus, not only would the Joint Venture approach create new voices, it would not create an exception to the multiple ownership rules. Its entire effect would be to bend toward de-consolidation.

*Fourth*, because the assets that could give rise to a Tax Certificate are likely to be high-value properties such as a full power TV stations or a major market FM station, there will be strong incentives to operate these incubators with high-performing managers who will graduate into high-performing owners.

As a result of these attributes, a Joint Venture would have these advantages as a regulatory vehicle to promote diversity:

- It would have a **sufficient business incentive** to motivate the incubating company to establish an incubator.
- It would have **sufficient likelihood of business success** to motivate the incubated company to be incubated.
- It would be designed in a way that would make a **reversion of the incubated station to the incubating company virtually impossible**.
- It would be designed in a way that makes it **virtually impossible for abuse or gamesmanship** to infect the program.
- It would **promote diversity and advance de-consolidation in a material and meaningful way**, with benefits to the public verifiable through cost-benefit analysis.

#### **D. An Illustration of How the Joint Venture Paradigm Would Work**

To help one visualize what a typical Joint Venture incubation would look like, here is an illustration of one that would result in a Tax Certificate:

In 2019, Company A, a radio station group owner, enters into a Joint Venture with Company B, which is headed by an experienced broadcast manager. Company B owns no radio stations. The Joint Venture, B&A Broadcasting Inc., buys WDIV-FM, an underperforming Class C2 facility in a top-50 market. Company A provides most of the funding for the purchase, while Company B contributes funds drawn from a line of credit. Company B has 20% of the equity and 60% of the voting shares in B&A Broadcasting. Company B has a call option

exercisable in three years for fair market value. In 2022, Company B exercises its call option, and a Form 316 application is filed to assign the license of WDIV-FM from B&A Broadcasting to Company B. At the closing, Company B purchases Company A's interest in B&A, and Company A receives a Tax Certificate allowing Company A to defer capital gains taxes on the sale of its interest in B&A upon reinvestment in comparable property. Company B's executive team was fully trained for three years as station owners and now has access to capital, having been successful in purchasing Company A's interest in B&A. Thus, in 2023, Company B can now enter the station transactional market, and begins to assemble its own station portfolio.

While this example is illustrative only, it represents one of several permutations under which the Joint Venture paradigm would promote diversity and benefit consumers. It is noteworthy that in this paradigm, there is virtually no risk of abuse, or of an unwind<sup>77</sup> that could result from a failure of the Joint Venture into which both companies have invested.

**E. Maintaining the Integrity of the Joint Venture Model**

The Commission asks these questions relevant to Joint Ventures:

*What combination of activities (financial and operational) should be required to qualify as an incubation relationship? Should there be any conditions on the financial aspects of the relationship? For example, should there be any limitations on the incubating entity holding an option to acquire the incubated station? Should we adopt time limitations on technical assistance? For example, should we impose a minimum amount of time to ensure that the incubated station acquires sufficient technical expertise to operate the station independently of the established broadcaster? Should we impose a maximum amount of time to ensure that the incubated station actually does become independent? What role should sharing agreements (e.g., LMAs, JSAs, and SSAs) play, if any, in the incubation relationship?*<sup>78</sup>

**Answer:** In Comments filed in February 2017, NABOB stated that while it had originated the incubator concept, it “has not pressed the proposal recently because of concern

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<sup>77</sup> Commission policy disfavors “unwinds.” See, e.g., *Little Dixie Radio, Inc.*, 25 FCC Rcd 4375, 4379 ¶6 (2010) (declining to unwind a transaction the Commission determined to have been wrongly approved by the Media Bureau, which violated a longstanding policy against granting applications with profit flowing to a seller whose qualifications are at issue).

<sup>78</sup> *Incubation NPRM*, 32 FCC Rcd at 9862 ¶134.

that the joint sales agreements (“JSAs”) and shared services agreements (“SSAs”) utilized by some broadcasters might be offered up as the model for such an incubator program”:

Many of the JSAs and SSAs permitted by the Commission over the past decade have provided no opportunity for actual minority ownership. In many of those arrangements, the minority licensee has relied almost completely upon the group station owner for financing, programming, advertising and operations, and the group owner has had an option, that lasted as long as 30 years, to purchase the minority licensee’s station at a price that did not appreciate over that 30-year period. This is not an incubator program.<sup>79</sup>

NABOB is correct. An incubator does not conduct startup training forever. It is intended to convey the ability to own and operate a *full-service* broadcast station – a station that, in time, might incubate others.

Bearing this in mind, the following rules should attach to every incubator using the Joint Venture paradigm:

1. JSAs and SSAs may be used only to assist in, and never to substitute for, incubation. If they are used at all, they must be used only for startup training, which was the original purpose of these instruments. On rare occasions, they might be useful for very new entrants, but they should not be long-lasting elements of incubation. If they are used at all, they should be used upon proof of need, and they should *never* last for more than one year. These one-year JSAs or SSAs should be designed to convey the skills necessary for operating complete sales department and complete station operations. These skills are of the type that all minority broadcasters had no difficulty learning on their own and mastering 30 years ago. If a broadcaster cannot acquire these fundamental skills in one year of initial incubation, and assume operation of a full-service station for the period of full-blown incubation, it was not ready to be a broadcast licensee in the first place.
2. Retransmission consent and network affiliation negotiations present the only exceptions to this “one year rule.” They are so complex and esoteric, and so vital to the success of a television station, that often they cannot be mastered even by experienced management in a single year. Thus, we recommend that retransmission consent negotiations (which typically occur annually) can be led by the incubating station for the first *two* years, and network affiliation

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<sup>79</sup> NABOB Comments, 2014 Quadrennial Review, MB Docket 14-50 (February 24, 2017) at 3. Committee members have pointed out that there are several television markets in which one broadcaster operates three or more stations by using SSAs or JSAs to sidestep the ownership and attribution rules.

negotiations (which typically occur every 3-5 years) can be led by the incubating station whenever they arise. In each such instance, the incubated station's management could sit "second chair" to learn the process. After those "second chair" experiences, the incubated station's management would handle these processes on their own.

3. It is unlikely that the period before the incubated station would exercise its call option would be less than the Incubation Period.<sup>80</sup> The option price should be no greater than fair market value, and there should be no option under which the incubating company can compel the incubated company to yield up the incubated station it has labored for years to operate and acquire.<sup>81</sup>

Another way to avoid shams or unsuccessful incubations is to design a category of gifts so substantial, to institutions so well established, that issues of economic disparity between the donor and donee, or of potential unwinds, would almost never arise. That paradigm is discussed below.

### **Paradigm 2: Major Institutional Gifts**

A Major Institutional Gift is the conveyance of a station to a Mission-Based Entity or a Native American Nation, which would become the station's licensee. The donated station could be any kind of station, in any market. Upon the making of such a gift, the incubating company could be eligible immediately for a tax deduction (as it is now under current law),<sup>82</sup> or a tax credit (if implementing legislation is enacted).<sup>83</sup>

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<sup>80</sup> See n. 71 *supra*.

<sup>81</sup> See p. 34 and n. 73 *supra*.

<sup>82</sup> See 26 U.S.C. §170 *et seq*.

<sup>83</sup> Often – especially if the station has little revenue – a tax deduction is not a sufficient incentive to donate a station. Often it is more advantageous to turn in the license and write down the license value, and sell the real estate. A tax credit would allow many small, "mom and pop" broadcasters to exit the industry with dignity in a manner that would provide them with fair market value for their life's work, while seeing their station repurposed to train the next generation of broadcasters.

The Commission may have had a paradigm such as Major Institutional Gifts in mind when it asked this question concerning incubation activities:

*As traditionally conceived, a comprehensive program could include management or technical assistance, loan guarantees, direct financial assistance through loans or equity investment, and training and business planning assistance.<sup>84</sup> Should we consider other activities, such as donating stations to certain organizations or arrangements whereby the new entrant gains operational experience without first acquiring a station, such as programming a station and selling advertising time under an LMA?<sup>85</sup>*

**Answer:** Incubation is for *ownership*. Only ownership conveys equity and decision-making authority, including the power to make programming decisions and speak in one's own voice. Thus, operation or rental would be insufficient.

Since the incubator program is aimed at fostering ownership, the incubated station must become an independent new voice. This could be accomplished in one of two ways: (1) the Mission-Based Entity or Native American Nation operates the station hands-on as a traditional owner, perhaps also training others to manage and own stations; or (2) the Mission-Based Entity or Native American Nation would LMA the station to an entrepreneur who already has experience managing a station, train the entrepreneur to acquire the additional skill sets needed to become an owner, and then sell the station at a deep discount to the entrepreneur once he or she is ready to complete the acquisition and become a licensee.

There are two caveats to this paradigm:

*First*, the gift should be structured in a way that would put to rest any possible suggestion that it is “programmed for failure.” The gift must be structured so that the asset is not “dumped” onto an institution unprepared to accept it. Some Mission-Based Entities or Native American

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<sup>84</sup> Citing DCS Comments, MB Docket 09-182 (July 12, 2010) at 22.

<sup>85</sup> *Incubation NPRM*, 32 FCC Rcd at 9862 ¶133.

Nations may not be in a financial position to cure serious engineering deficiencies, build a new studio, or triage a rapidly failing sales operation that is plunging the station deep into debt. It would be appropriate for the donor to provide working capital and perhaps a loaned executive to ensure the financial solvency and economic success of the venture. Fortunately, there are examples of station donations that were programmed for success, such as the Washington Post Company's donation of the 96.3 MHz frequency (now WHUR-FM) in Washington, D.C. to Howard University in 1969, or American Spirit's 2013 donation of WLOO-TV, Jackson, MS, to Tougaloo College.<sup>86</sup>

*Second*, unlike a Joint Venture incubator, there may be instances where a JSA or SSA is appropriate for a Major Institutional Gift. A Mission-Based Institution or a Native American Nation may choose to accept the station so it can train broadcasting students, generate revenue, and create and transmit programming that tells the recipient's story and furthers its mission. Thus, the Institution or Nation is in a position not unlike that of a troubled newspaper that enters into a Joint Operating Agreement ("JOA") in order to preserve its independent editorial content while contracting, to its in-market competitor, the sales, printing and distribution functions. Through this vehicle, some communities have been able to retain two newspapers' competing editorial voices. In some instances, a similar and limited use of a JSA or SSA for a Major Institutional Gift could be appropriate. Importantly, though, the JSA or SSA should be structured so that it is not a sham device to allow the donor to retain direct or indirect control of the station's programming. In that scenario, the "gift" would be no gift at all. The donee would have received "100% of nothing."

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<sup>86</sup> See p. 28 *supra*.

#### **IV. Benefits to Incubating Station**

##### **A. Evaluation of Eligibility**

The Commission asks these questions regarding benefits to the incubating company:

*In order to encourage an established broadcaster to engage in incubating activities, the incubation program must provide a meaningful benefit to the incubating entity. In general, the potential benefit suggested has been a waiver of the Commission's local broadcast ownership rules. How should the Commission structure the waiver program? For example, should the waiver be limited to the market in which the incubating activity is occurring? Alternatively, should [a] waiver be permissible in any similarly sized market? How would the Commission determine which markets are similar in size? Should the Commission review these waivers in the future to determine whether they continue to be justified? On what grounds would the Commission evaluate the waivers? Should the waiver be tied to the success of the incubation relationship? Should the waiver continue even if the incubator program ends and, if so, for how long? What should be considered a successful relationship? Should the waiver be transferrable if the incubating entity sells a cluster of stations that does not comply with the ownership limits at the time?<sup>87</sup>*

**Answer:** The decision to approve or not approve a tax benefit is a binary decision, and, if approved, the tax benefit should be permanent. Otherwise there would be little incentive for broadcasters to undertake incubation.

Under the Joint Venture paradigm, questions regarding differences between the incubating company's market and the incubated company's market are moot. They are the same market because the station at which incubation occurs and the station for which the Tax Certificate is sought is the same station.

Under the Major Institutional Gifts paradigm, the station could be in any market, and the only factor affecting its genuineness for tax purposes is the assuredness that the station will not be reverting to the donor because it has negligible value or is likely to fail. In evaluating tax-advantaged transactions and gifts, the IRS is quite fastidious, requiring appraisals for gifts over

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<sup>87</sup> *Incubation NPRM*, 32 FCC Rcd at 9862 ¶137.

\$5,000.<sup>88</sup> Thus the FCC has little to worry about regarding potential abuse of a Major Institutional Gift.

The Joint Venture paradigm contemplates an Incubation Period during which an eligible entity will be thoroughly incubated, after which it would be entitled to buy out its partner. Such a transaction would require the filing of a Form 316 application. The filing of such an application would trigger public scrutiny under 47 U.S.C. §309(d) and public interest review by the Commission under 47 U.S.C. §309(e).

Incubation activity and *bonafides* would be reported on a “Public Interest Report” detailing how the public would benefit and has benefitted from the incubation program. The Public Interest Reports would be filed with the original Form 314 or Form 315 application on the commencement of an incubation, would be updated annually, and would be provided with a Form 316 upon the conclusion of an incubation. Thus if the incubation relationship were a failure, such that the parties just “went through the motions”; or the governing relationship was programmed for failure such that no incubated company could possibly succeed or exercise its option to take out the incubating company and become independent; or no one underwent any significant training to become an owner; or the incubated company failed to gain any traction in raising capital based on its own independent *bona fides*, the Commission would know.

Since members of the public would seldom be aware of the underlying facts, the Commission should make it clear that its staff will carefully review Form 314 or Form 315 applications to establish incubators, Form 316 applications upon the conclusion of an

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<sup>88</sup> See IRS Publication 561, Determining the Value of Donated Property (Appraisals) (Rev. April 2007).

incubation,<sup>89</sup> the annual Public Interest Reports, and organic documents such as Joint Venture partnership agreements and options. This is as it should be: as the Commission recognized ten years ago, a program aimed at affording any party a privilege not available to all must be ethically ironclad in order to maintain the public's trust.<sup>90</sup>

Still, there are circumstances in which good judgment should authorize a Tax Certificate to be granted even if the incubation was not completely successful. Suppose, for example, that in the second year of an Incubation Period, an Act of God, or an economic depression, caused the incubated company to falter, such that the only way to save the venture was for the incubating company to have a court eject the incubated company and have the station placed in a trust. In such a scenario, and upon verifying that the parties otherwise did all they reasonably could have done to effectuate the terms of the incubation, the Commission should allow the trustee to sell the station, require that the incubating company be permitted to enter into a Joint Venture with a new incubated company to buy the station from the trustee, restart the Incubation Period clock and, ultimately, award the Tax Certificate.

## **B. Scope and Potential Expansion of the Incubation Program**

The Commission asks:

*Should we limit any incubator program to radio, as the proposal was initially conceived, or should the program apply to both radio and television? Should we adopt a phased approach, whereby we institute the program on a trial basis in radio and then evaluate its success and operation before expanding to television,*

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<sup>89</sup> Commission review of Form 316 applications upon the conclusion of an incubator is particularly important because members of the public generally lack standing to file a petition to deny a Form 316 application. Consequently, members of the public almost never challenge such applications.

<sup>90</sup> See *Diversification of Ownership In the Broadcasting Services, 2006 Quadrennial Regulatory Review*, Report and Order and Third Further Notice of Proposed Rulemaking, 23 FCC Rcd 5922, 5941-42 ¶¶43-48 (2008) (granting DCS' proposal for a "zero tolerance" policy for ownership fraud).

*and if so, how long should such a trial period last? What steps should the Commission take to evaluate the trial period and whether to expand the program?*<sup>91</sup>

**Answer:** Diversity in local broadcast ownership has been at risk even before the recent decisions and potential decisions that could lead to further consolidation.<sup>92</sup> Thus, irrespective of one's views on the current structural rulemakings, it is especially vital that the Commission promptly adopt an incubation program focused on local radio and television.

The program we have recommended is neutral as to the structural litigation. The program we have conceptualized would have no impact on consolidation except insofar as it has the potential to deliver new voices into many broadcast markets. The incentives we have built into our proposal are proven “win-win’s” based on delivering modest tax benefits to the incubating companies.

## **V. Review of Incubation Proposals**

### **A. Review on Behalf of Consumers' Interests**

With respect to review of incubation proposals by and on behalf of consumers' interests, the Commission asked these questions:

*We seek comment on the review process for incubation proposals. We expect that most incubation proposals will accompany an assignment or transfer of control application. These applications would be subject to petitions to deny and informal comments under the Commission's rules. Does this provide the public with sufficient opportunity to comment on the proposal? What public concerns should the Commission consider in its evaluation? Are there other situations beyond an assignment or transfer of control application in which an incubator*

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<sup>91</sup> *Incubation NPRM*, 32 FCC Rcd at 9863 ¶139.

<sup>92</sup> See 2014 *Quadrennial Regulatory Review – Review of the Commission's Broadcast Ownership Rules and Other Rules Adopted Pursuant to Section 202 of the Telecommunications Act of 1996*, Order on Reconsideration and Notice of Proposed Rulemaking, 32 FCC Rcd 9802, 9837-9840 ¶¶78-82 (2017) (“2014 Quad Review Reconsideration Order”) (contemplating further deregulation of local television ownership).

*proposal could be applied, and if so, how should the review process work in such circumstances?*<sup>93</sup>

**Answer:** As we have noted above:

Incubation activity and *bonafides* would be reported on a “Public Interest Report” detailing how the public would benefit and has benefitted from the incubation program. The Public Interest Reports would be filed with the original Form 314 or Form 315 application on the commencement of an incubation, would be updated annually, and would be provided with the Form 316 application associated with a request to conclude an incubation. Thus if the incubation relationship were a failure, such that the parties just “went through the motions”; or the governing relationship was programmed for failure such that no incubated company could possibly succeed or exercise its option to take out the incubating company and become independent; or no one underwent any significant training to become an owner; or the incubated company failed to gain any traction in raising capital based on its own independent *bona fides*, the Commission would know.

Since members of the public would seldom be aware of the underlying facts, the Commission should make it clear that its staff will carefully review Form 314 or Form 315 applications to establish incubators, and Form 316 applications to conclude incubators, as well as the annual Public Interest Reports, including organic documents such as Joint Venture partnership agreements and options. This is as it should be: as the Commission recognized ten years ago, a program aimed at affording any party a privilege not available to all must be ethically ironclad in order to maintain the public’s trust.<sup>94</sup>

The possibility that a member of the public will file a petition to deny provides only a slight deterrent to abuse. Most abuse cannot be uncovered by members of the public because abuse is too easy to conceal. While there is a procedure for launching a challenge at any time, the procedure is so obscure that it has not been successfully invoked since 1972.<sup>95</sup> Only

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<sup>93</sup> *Incubation NPRM*, 32 FCC Rcd at 9863 ¶140.

<sup>94</sup> See pp. 44-45 *supra* (fns omitted).

<sup>95</sup> The primary occasions on which members of the public can bring fraud and abuse to the Commission’s attention are upon the filing of Form 314 or Form 315 applications, unless the station files a license renewal application during the Incubation Period. Abuses may be brought to the Commission’s attention immediately by asking the Commission to call in a renewal application early and then designate it for hearing. However, the last time this procedure was successfully used was in *Leflore Broadcasting Co.*, Memorandum Opinion and Order, 36 FCC2d

experienced communications attorneys know where to look and how to “pierce the veil.” Seldom is there pre-designation discovery;<sup>96</sup> nor is there any economic incentive to file petitions to deny. Consequently, only careful audits by professional FCC staff are likely to uncover abusive or sharp practices that skirt the edges of ethical operations.

Incubators should not pose great administrative difficulties – any more than Memoranda of Understanding (“MOUs”) and similar arrangements containing conditions to mergers. Such conditions are commonplace in FCC practice.

Substantively, the most important red flags are arrangements modeled after SSAs and JSAs but posing as incubators, except where they may be needed for startup training in the first year of an incubation relationship; and options set up to ensure that the incubating company will inevitably take out the incubated company for much less than actual value.<sup>97</sup>

Relative to enforcement actions such as those involving children’s television, political broadcasting, obscenity, equal employment, structural ownership, the attribution rules, and general character requirements, the proposed incubator program should be relatively easy and inexpensive to administer. Nor should this proposed program be expensive to administer when compared to previous diversity programs. The FCC administered the Tax Certificate Policy from 1978-1995 with little difficulty, giving out over 200 Tax Certificates during those 17 years. This proposed program is a cousin of that policy.

Regarding the nexus between incubation and new entry, the Commission asks:

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101, 102 (1972), a case involving blatant racial discrimination in employment. As noted above, it is almost impossible to challenge a Form 316 application. *See n. 89 supra*.

<sup>96</sup> *But see Bilingual Bicultural Coalition on the Mass Media v. FCC*, 595 F.2d 621, 628-30 (D.C. Cir. 1978) (requiring pre-designation document production where the licensee has exclusive access to all of the facts necessary to a determination of whether it is qualified for renewal).

<sup>97</sup> *See Edwards*, 16 FCC Rcd at 22249 ¶24.

*How can the Commission ensure that use of the incubation program is necessary to promote new entry? For example, should the proposed incubated station certify that it lacks the access to capital and technical expertise necessary to acquire and operate the station? Should participation in an incubator program be limited to new station acquisitions? Alternatively, should participation extend to existing station owners that are struggling and may need financing or other support to continue operation? Are there any justifications for limiting participation differently based on the eligibility standard selected?<sup>98</sup>*

**Answer:** In the ideal scenario for incubation, the incubated company is capable of running a business, but lacks the access to capital and deep expertise necessary to acquire and optimally run a broadcast station; nonetheless, it would be able to acquire these attributes through incubation.

FCC counsel to every applicant for incubation would carefully plead that the incubated company lacks the capital or expertise to acquire and operate the station without incubation. The only applicants not certifying to lack of access to capital or lack of expertise would be entities so inexperienced that they failed to engage experienced FCC counsel. Consequently, such a certification would be meaningless in practice.

A better approach would be for the Commission to designate an expert on broadcast finance and operations – such as a staff member of OCBO – to interview the applicant’s control persons and assess their readiness to operate as the controlling parties of a broadcast licensee. In the ideal incubation scenario, the structure and terms of the incubation relationship should naturally lead the entrepreneurs to acquire the additional expertise necessary for the capital formation ultimately leading to successful long-term ownership.

The Commission has inquired regarding the existence of incubators that pre-date the filing of formal incubation proposals to the Commission. This issue should seldom, if ever, arise

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<sup>98</sup> *Incubation NPRM*, 32 FCC Rcd at 9862 ¶135.

because we know of no existing incubations-in-progress that would qualify under either the Joint Venture or Major Institutional Gifts paradigms.

Committee members pointed out that navigating the FCC's processes is often challenging. Thus, we recommend that OCBO designate a senior staff member to serve as a guide to assist potential incubatees in navigating the process.

**B. Incubation of Incumbent Licensees; Stations in Distress**

A potential use of incubation is presented when a company is an established broadcaster but wishes to grow in a substantial way that might benefit from incubation, *e.g.*, becoming a specialist in multiple languages; transitioning from one station to multiple stations or markets; expanding from a small market to a large market; or making the leap from radio into television. In these scenarios, incubation could provide initial education, comprehensive education, or continuing education.

Regarding stations in distress, the Commission asks:

*We asked above whether to extend incubation opportunities to existing station owners that are facing financial and/or technical difficulties.<sup>99</sup> If the program is so extended, how should the parties submit the proposal to the Commission for review and approval? For example, should we require electronic filing of such requests in the Commission's Electronic Comment Filing System? Should these filings then be subject to the same public comment requirements as those filed as part of an assignment or transfer of control application?<sup>100</sup>*

**Answer:** Under the Joint Venture paradigm, a "target station" being developed as an incubator may well have been chosen precisely because it has experienced financial difficulties, albeit it has a competitive signal. Often this happens because the station is in the wrong format

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<sup>99</sup> *Incubation NPRM*, 32 FCC Rcd at 9862 ¶135 ("Should participation in an incubator program be limited to new station acquisitions? Alternatively, should participation extend to existing station owners that are struggling and may need financing or other support to continue operation?")

<sup>100</sup> *Incubation NPRM*, 32 FCC Rcd at 9863 ¶141.

and the owner does not know how to program for the “format hole” (or language) that the market, with its changing demographics, has now created. Sometimes financial difficulties occur because the current owner has not kept up with modern technology, has not installed competitive management, or is simply exhausted after years of struggle. Often the public would be best served if the incumbent owner retired with dignity and sold the station to an entrepreneur who would deliver it into incubation. Nonetheless, sometimes the incumbent owner of the target station, in a “last hurrah” moment, will want to be incubated itself – essentially be brought into the 21<sup>st</sup> century with up-to-date management techniques that will make its station competitive. Many broadcast members of the Committee have witnessed similar scenarios play out, as owners, past their prime, flirt with bankruptcy in negotiating with lenders and investors. This often fails to end well. Still, the Commission should not entirely rule out incubation as a rare method of addressing this type of scenario.

### **C. Pre-existing Incubation Relationships**

On the subject of pre-existing incubation relationships, the Commission asks:

*We note that so long as the arrangement is permissible under existing Commission rules, parties do not need prior approval to enter into agreements regarding finances or station operations. However, for the arrangement to count as incubation, such that the incubating entity is entitled to the benefits of the program (e.g., an ownership waiver), the Commission would need to find that the relationship satisfies the incubation criteria. In such circumstances, should we require Commission approval prior to the initiation of the incubation relationship or should we permit the parties to request recognition of a previous or ongoing incubation relationship, perhaps as part of an application from the incubating entity requesting an ownership waiver for the acquisition of another station? Should there be a time limit on such subsequent requests for approval?<sup>101</sup>*

**Answer:** We know of no pre-existing incubation relationships that currently meet the tests of a Joint Venture or a Major Institutional Gift, as those paradigms are described in these

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<sup>101</sup> *Incubation NPRM*, 32 FCC Rcd at 9864 ¶142.

Comments. Should new relationships come into existence after an incubation program is created, the parties to those relationships should be expected to notify the Commission immediately of their existence and of their intention to seek relief under the incubator program. Such notifications are necessary to ensure transparency and avoid the appearance of gamesmanship later.

## **VI. Compliance Assessment**

The most common issue arising with respect to compliance with any diversity program is licensee control. On that subject, the Commission asks:

*While the Commission's rules already prohibit unauthorized transfers of control, including de facto transfers of control, should we adopt any additional safeguards as part of an incubation program to ensure that the incubated station licensee retains control of its station?*<sup>102</sup>

**Answer:** The essence of the incubation program is the course of activity that occurs, not the identity of the party overseeing the activity. Thus, suppose the controlling entity of the incubated company changes hands. As long as the successor entity would also qualify as an eligible entity,<sup>103</sup> the handoff should not impact the incubating company's eligibility for a tax benefit.

A problem could arise if the successor company in a Joint Venture does not qualify as an eligible entity. To avoid this scenario, we should look to Commission precedent in the administration of other programs for which a benefit is dependent upon events over which the applicant has little or no control. The case law is fairly consistent in establishing that the Commission does not penalize an applicant where the cause of nonperformance is an Act of

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<sup>102</sup> *Incubation NPRM*, 32 FCC Rcd at 9863 ¶136.

<sup>103</sup> *See, e.g.*, 47 C.F.R. §73.865(a)(2) (prohibiting assignment of an LPFM license to anyone who could not have qualified for a grant in the first instance, such as a proposed assignee that isn't noncommercial).

God or another circumstance that the applicant could not reasonably have anticipated and that it could not have controlled or corrected.<sup>104</sup>

Regarding overall compliance monitoring and assessment, the Commission asks:

*As evidenced by the foregoing, an incubation relationship may involve complex agreements between the parties regarding financing, programming, and operations. How should the Commission monitor compliance with the terms of incubation? Should the Commission require periodic reports to be filed by one or both parties or placed in their online public files? If so, how frequently should the reports be filed? Should these reports be available to the public? What information should the reports contain? Should the Commission instead conduct its own periodic review of the incubation activities and compliance with the relevant agreements? What other compliance measures should we consider?*<sup>105</sup>

**Answer:** In the case of a Major Institutional Gift, once the gift is made and the tax deduction or credit is granted, no further reporting should be necessary. In the case of a Joint Venture, it should be sufficient for the incubated company to place annual Public Interest Reports in the station's online public file. Similar Public Interest Reports would also need to be provided with the Form 316 application to be filed when a Tax Certificate is sought.

Regarding lapses in compliance, the Commission asks:

*If compliance lapses, for any reason, what are the consequences? Should the incubating party be required to divest itself of the benefits it received for engaging in incubation activities? For example, if the incubating party was granted a waiver of a local broadcast ownership rule, should it be forced to come into compliance with the relevant ownership limit if it does not fulfill the terms of the incubation program? Should we allow the incubating party to seek to be relieved of its obligations and retain the benefits (e.g., ownership waiver) if the incubated station fails to comply with the terms of the agreement? Are there other appropriate enforcement responses, such as fines? Should we establish a time limit on the benefits granted under the incubation program based on the premise that the purpose of the program is to enable incubated entities to operate independently after some period of assistance?*<sup>106</sup>

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<sup>104</sup> See 47 C.F.R. §73.3598(b)(1) (providing that the Commission can cite an Act of God as a ground for tolling a construction period or extending a construction period deadline).

<sup>105</sup> *Incubation NPRM*, 32 FCC Rcd at 9864 ¶143.

<sup>106</sup> *Incubation NPRM*, 32 FCC Rcd at 9864 ¶144.

**Answer:** In the case of a Major Institutional Gift, there would never be a need for disgorgement, because the gift would “speak for itself” and the tax deduction or tax credit, once granted, would be final.

In the case of a Joint Venture, the Tax Certificate would not be granted until the end of the Incubation Period. The Commission would have before it a Form 316 and supporting documentation, and it would be able to review the entire record of the incubation before granting the Certificate. In this way, there would never be a need to reopen a Certificate grant once it has been awarded, and there would never be a need for disgorgement.

If the Commission found that the incubation arrangement had been noncompliant but not with the intent to deceive the Commission, it could impose a forfeiture, reporting conditions, or a short-term renewal, while granting the Certificate.

If the Commission found that the incubation arrangement had been noncompliant, rising to the level of a sham with the intent to deceive the Commission, it should treat the matter as it would if the applicants were before it having made material misrepresentations or having committed an intentionally unauthorized transfer of control. As it would in any other misrepresentation or unauthorized transfer case, it would withhold action on the Certificate request, and determine whether the information before it constituted a substantial and material question of fact requiring designation for hearing under 47 U.S.C. §309(e). Whether or not a hearing was required, penalties could be assessed against both parties to the transaction.<sup>107</sup>

If the misconduct had been committed only by the incubated company, the incubating company should not be issued a sanction; but neither should it be able to obtain a Certificate, since the public would not have received any benefit from the arrangement. If the incubating

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<sup>107</sup> See, e.g., *Edwards*, 16 FCC Rcd at 22248 ¶¶20-21.

company had been paying attention, it would always have noticed its partner's misconduct, and it could have demanded and obtained a cure. The defense of "we had no idea, and are shocked, shocked" is not available. An investor, especially one hoping to secure a special and valuable benefit from the government, is either paying close attention to her investment or is seriously negligent if she overlooks a sham by its partner in a Joint Venture largely funded by the investor's capital.

## **VII. Costs and Benefits**

Regarding costs and benefits, Commission asks:

*We seek comment on the costs and benefits associated with the proposals in this NPRM. In particular, we encourage broadcasters and other industry participants to submit any relevant data regarding the potential costs associated with the various application, recordkeeping, and compliance requirements proposed herein. Are there ways to structure the program to reduce costs, particularly for small businesses? How do we define and quantify the expected benefits of an incubator program?*<sup>108</sup>

**Answer:** The Committee enthusiastically endorses cost-benefit analysis as a key element of the Commission's evaluation of the incubator program. Since the program is a means of providing benefits to consumers, and because the program would achieve this goal by granting tax benefits that are not available to everybody, it is especially critical that the benefits clearly outweigh the costs.

Fortunately the costs are readily discernable – preparation of application materials; selection and training of administrative and oversight staff, and consideration of applicants' non-technical submissions. These costs are not great relative to other FCC undertakings. Nonetheless, the benefits must be clearly discernable as well as significant.

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<sup>108</sup> *Incubation NPRM*, 32 FCC Rcd at 9864 ¶145.

The paperwork requirements associated with this program are minimal. The information that would be reported to the public in the annual Public Interest Reports is essentially the type of information that every competent station owner requires her line managers to assemble as a core element of “management by objectives.”<sup>109</sup> Thus there is no additional burden incurred in simply making this information available to the listeners and viewers and to the Commission.

The expected benefits of an incubator can be quantified, to a reasonable extent, using the following metrics, which also should comprise most of the Public Interest Reports:

- Senior managers trained in the skill sets necessary to becoming owners;
- Willingness of financial institutions to consider making equity or debt financing available to the incubated company as it seeks to acquire the incubating company’s interest in the Joint Venture; and
- Service of the new station as an independent voice, including new or additional non-entertainment program offerings (such as news or public affairs offerings) responsive to local needs and interests and, especially, to needs and interests (including programs in languages other than English) that may not be addressed by other stations in the market.

Costs that should be taken into account include:

- Formulation, approval, and dissemination of application materials;
- Selection, training and credentialing of evaluators; and
- Program administration, including review up the agency personnel chain.

Other metrics, and other anecdotal factors not easily reducible to quantitative terms, may also be worthy of consideration as part of the Commission’s cost-benefit analysis.

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<sup>109</sup> See *Management by Objectives*, The Economist (October 21, 2009), available at <http://www.economist.com/node/14299761> (last visited February 21, 2018) (defining management by objectives (“MBO”) as a system where long-term objectives are collectively agreed upon, giving a team flexibility to work toward those goals within their own areas of responsibility without getting sidetracked by activity level).

### **VIII. A Response to Earlier Commission Objections to the Incubator Concept**

As noted in Section II *supra*, an earlier Commission and others had expressed objections to the incubator concept. In light of the details set out in Section III-VII above, we now address these objections.

*First*, objectors suggested that the proposal might permit increased consolidation, resulting in a net decrease in minority and female ownership. We have designed this program in a manner that would lead to no new consolidation. Our choice of incentive is tax relief. The program we have designed would deliver new voices to markets. Creating a new voice is a tangible benefit to the public, long recognized by the Commission.<sup>110</sup>

Adding to the need for new voices are the profound changes in market demographics since the last time Congress calibrated the local radio rules.<sup>111</sup> Demographic changes since the 1990s underscore the need to provide more broadcast outlets for new voices, and especially for voices speaking in additional languages. In particular (reporting the most recent Census Bureau estimates), from 1990 to 2016:<sup>112</sup>

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<sup>110</sup> As early as 1970, the Commission recognized that “[a] proper objective is the maximum diversity of ownership that technology permits in each area. We are of the view that 60 different licensees are more desirable than 50, and even that 51 are more desirable than 50. In a rapidly changing social climate, communication of ideas is vital.... It might be that the 51st licensee...would become the communication channel for a solution to a severe local social crisis. No one can say that the present licensees are broadcasting everything worthwhile that can be communicated.” *Multiple Ownership of Standard, FM and Television Broadcast Stations*, First Report and Order, 22 FCC2d 306, 311 (1970).

<sup>111</sup> See *2014 Quad Review*, 29 FCC Rcd at 4515 ¶313 (rejecting incubator proposal in 2014, reasoning that the “local radio rules have been carefully calibrated to protect competition and new entry. By allowing broadcasters to exceed these caps, DCS’s proposal could result in more local radio consolidation than is presently permitted under our rules.”) Those rules were last calibrated in the 1996 Act, in which Congress also provided for adjustments over time. Telecommunications Act of 1996, Pub. L. No. 104-104, §202(h), 110 Stat. 56, 111-12 (1996). The rules can be found at 47 C.F.R. §73.3555(a)(1).

<sup>112</sup> All sources last visited February 20, 2018.

**Total Population: a 30% increase**

- **1990 Census:** 248,709,873  
<https://www.census.gov/main/www/cen1990.html>
- **2016 Census Estimate:** 323,127,515  
[https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS\\_12\\_1YR\\_DP05&prodType=table](https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_12_1YR_DP05&prodType=table)

**Number of ethnic minorities (including Hispanics of any race): an 80% increase**

- **1990 Census:** 49,023,803  
<https://www.census.gov/population/www/documentation/twps0076/twps0076.pdf>
- **2016 Census Estimate:** 88,483,476  
[https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS\\_12\\_1YR\\_DP05&prodType=table](https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_12_1YR_DP05&prodType=table)

**Number of primary speakers of languages other than English: a 109% increase**

- **1990 Census:** 31,844,979  
<http://www.languagepolicy.net/articles/census02.htm>
- **2016 Census Estimate:** 64,716,000  
<https://www.migrationpolicy.org/article/language-diversity-and-english-proficiency-united-states>

The Commission’s concerns that it was not clear who would benefit from incubation, and its skepticism about the use of an SDB definition for eligible entities, are valid. In Section III *supra*, we identified three workable, constitutionally permissible paradigms for eligible entities. Owing to constitutional concerns, we specifically decided not to recommend the use of an SDB definition at this time.<sup>113</sup>

We responded to the Commission’s doubts that it would have the capacity to monitor adequately the activities that would qualify a company for incubation. A Joint Venture is designed to incentivize incubation-activity performance without the need for extensive

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<sup>113</sup> See n. 29 *supra*.

monitoring, and a Major Institutional Gift is designed to enable the Commission to acknowledge an incubation for tax reporting purposes contemporaneously with the making of the gift, thus obviating the need for monitoring.

The Commission grants broadcasters a wide variety of benefits in reliance on the benefits that broadcasters provide to the public.<sup>114</sup> The task of monitoring incubators' public interest performance should not be difficult by comparison. *See* §§VI and VII *supra*.

### **IX. The Incubator Program in the Context of Structural Deregulation**

We close where we began – with the Third Circuit's February 6, 2018 *Order* directing the Commission to report on the incubator program by August 6, 2018.<sup>115</sup> Clearly the Court wants assurance that the program will yield *substantial* benefits for the public, given the very long history of FCC delay in addressing the need for diversity in broadcasting.<sup>116</sup> To soothsay the

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<sup>114</sup> *See, e.g., Applications of Comcast Corporation, General Electric Company and NBC Universal, Inc. for Consent to Assign Licenses and Transfer Control of Licenses, MB Docket No. 10-56, Memorandum Opinion and Order, 26 FCC Rcd 4238, 4371-72 (2011) (diversity conditions to merger). More generally, in Section 257 of the Telecommunications Act of 1996, codified at 47 U.S.C. §257, Congress expects the Commission to monitor its own efforts to close market entry barriers.*

<sup>115</sup> *See Prometheus IV Scheduling Order, supra.*

<sup>116</sup> In 1976, the Commission rejected all 62 rulemaking proposals submitted in 1973 by the National Black Media Coalition. Dissenting as to 31 of the rulings, Commissioner Benjamin Hooks was highly critical of the Commission's three-year delay in ruling. *Rules and Policies to Facilitate Public Participation and Reregulation of the Various Communications Industries in the Public Interest, Memorandum Opinion and Order, 61 FCC2d 1112 (1976) and Citizens Communications Center, Memorandum Opinion and Order, 61 FCC2d 1120 (1976).* Decades later, a three year delay would look like warp speed. In 2004 and again in 2016, the Third Circuit of the U.S. Court of Appeals had to remind the Commission of its duty to consider non-controversial race-neutral minority ownership proposals, some of them pending for well over a decade. *See Prometheus I, 373 F.3d at 421 n. 59 and Prometheus III, 824 F.3d at 50 n. 11.* The original incubator proposal was offered by NABOB in 1990, has been pending in seven dockets, and is now in its 29<sup>th</sup> year of consideration. If it remains pending in 2019, the incubator proposal will be old enough to be sworn in as a member of the United States Senate. *See* U.S. CONST, art. I, §3, cl. 3.

benefits to the public of this incubator program, it is the sense of the Committee, recalling the scale of industry acceptance and participation in the 1978-1995 Tax Certificate Policy, that a program designed approximately as set out in these Comments should generate between 5 and 50 radio applications and between 5 and 25 television applications in each of its first three years, *provided that*:

- Congress passes implementing legislation;<sup>117</sup> and
- The program is readily, enthusiastically, and *efficiently* implemented, so that broadcasters find it user-friendly.

The Committee takes no position on whether the *existence* of an incubator program, along the lines of the program described in these Comments, could justify or mitigate various deregulatory steps taken in the 2014 Quadrennial Review proceeding<sup>118</sup> and, perhaps, additional steps that may be taken in the 2018 Quadrennial Review that is soon to be underway. Rather, we

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<sup>117</sup> Since Congress repealed the Tax Certificate Policy in 1995, several bills have been introduced to replace it. These bills were race-neutral, would apply to telecom as well as broadcasting, and included caps on deal size and on program size. The bills were introduced by Senators John McCain and Robert Menendez, and by Congressmen Charles Rangel, Bobby Rush and G.K. Butterfield. None of these bills was afforded a hearing in the House Ways and Means Committee, where tax legislation must begin.

One of the reasons it has been difficult to secure the restoration of the 1978 Tax Certificate Policy is that a Certificate would have to be issued for a sale to any eligible entity, such as a small business - a classification that includes nearly all broadcast companies. *See* n. 28 *supra*. Consequently the taxpayers would be paying to incentivize transactions that would mostly happen anyway. Under our proposal, though, taxpayers would only be incentivizing sales to a much smaller subset of entrepreneurs: those who (1) really need incubation; and (2) have overcome significant disadvantages to earn it. Giving Tax Certificates only where there had been a period of real incubation would sharply focus the Policy, improve its efficiency, and thus make it more likely that Congress would authorize it. Further, Congress would be able to phase in the program gently, since the first Certificates would not be issued immediately.

<sup>118</sup> *See generally* 2014 *Quad Review Reconsideration Order*, 32 FCC Rcd 9802 (repealing, subject to judicial review, the Newspaper/Broadcast Cross-Ownership Rule and the Radio/Television Cross-Ownership Rule; and relaxing the Local Television Ownership, Television JSA and Shared Service Agreements attribution rules).

pray that the Commission will adopt, with enthusiasm, the incubator proposal recommended in these Comments because that would be the right thing to do to advance diversity and inclusion in the nation's most important and influential industries.

Respectfully submitted,

Federal Communications Commission Advisory  
Committee on Diversity and Digital Empowerment

April 1, 2018